KOLLEGIET
FÖR SVENSK BOLAGSSTYRNING

Annual report 2008

Contents

Foreword

The Swedish Code of Corporate Governance has now been in force for large stock exchange listed companies for three years. So far, experience of using the Code has been mainly positive. All the companies that have been obliged to abide by the code have done so diligently. At the same time, companies have applied the Code with the flexibility that was intended and have not hesitated to adopt alternative solutions - and report and explain them - when the Code's proposed solution has not been deemed to be the most appropriate in a particular case.

It was against this background that the Swedish Corporate Governance Board decided in September 2007 to initiate a broadening of the scope of the Code to cover all Swedish companies whose shares are traded on regulated markets, in accordance with the plan presented when the Code was originally introduced. The Board also commenced a major review of the Code in order to adapt it to the needs and conditions of this wider target group. The revised Code was published on 7 May 2008 and is applicable to all companies listed on the OMX Nordic Exchange Stockholm and NGM Equity from 1 July 2008.

Naturally, the work of the Corporate Governance Board this year has been very much focused on the task of revising the Code, which is reflected in the Board's annual report for 2008.

As in previous years, the first part of the report describes the Board's mission, its work during the year and its views on how Swedish corporate governance has developed in the year since the previous annual report. The last chapter of the first part of the report deals primarily with the reasons for broadening the scope and revising the Code, as well as the most important changes compared with the previous version.

The second part of the report describes the results of the Board's follow up and evaluation of how the Code has been applied during the year as part of its work to continuously develop and improve the Code.

The final chapter is an extract from an informal discussion arranged by the Board on the future of self-regulation in Sweden between the Swedish Minister for Justice, Beatrice Ask, and Anders Nyrén, the chair of the Association for Generally Accepted Principles in the Securities Market. The background to the discussion is the concern felt by the Board that increased legislative activity, partly as a result of EU directives, will lead to unnecessarily far-reaching and detailed regulation and thus undermine the role of self-regulation in the field of corporate governance.

It is the hope of the Board that this report will contribute to an increased understanding of the importance of good corporate governance and to continued constructive work to develop Swedish corporate governance.

Stockholm, June 2008

Hans Dalborg
Chair of the Board

ACTIVITY REPORT

This part of the annual report describes the work of the Board during 2007–2008 and discusses current issues regarding the Code, how it is applied and Swedish corporate governance in general.

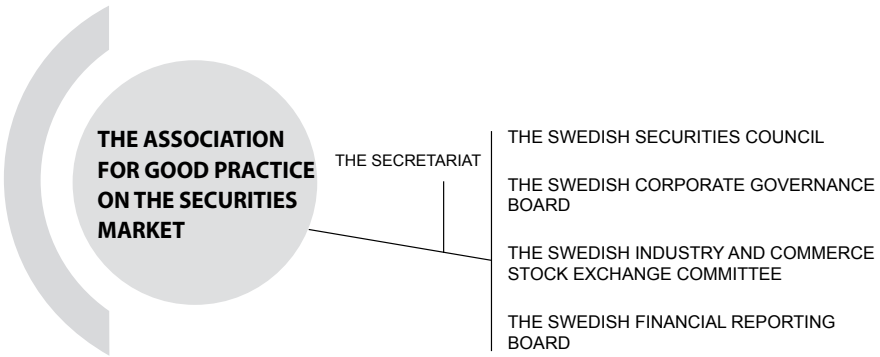
The mission of the Swedish Corporate Governance Board

The mission of the Swedish Corporate Governance Board is to promote the positive development of corporate governance in Swedish stock exchange listed companies, primarily by ensuring that Sweden continuously has a relevant, modern, effective and efficient corporate governance code, but also through activities designed to build confidence in the corporate governance of listed companies in the capital markets and among the general public. The Board is also to promote Swedish interests internationally within the field of corporate governance.

The Board is one of the four bodies that constitute the Association for Generally Accepted Principles in the Securities Market, an association set up in 2005 to oversee self-regulation within the securities market. The other three bodies in the association are the Swedish Securities Council, the Swedish Industry and Commerce Stock Exchange Committee and the Swedish Financial Reporting Board. This association reports in turn to a number of organisations in the private sector that are affected by these issues. See illustration below.

The Board is responsible for determining norms for good corporate governance of listed companies. It does this by ensuring that the Swedish Code of Corporate Governance remains appropriate and relevant, not only in the Swedish context, but also internationally. The Board monitors and analyses how companies apply the Code through continuous dialogue with its users, both in seminars and meetings and with the aid of a variety of structured surveys. It also closely follows the general debate on the subject, changes in legislation and regulations concerning corporate governance, developments in other countries and academic research in the field. Based on this work and other relevant background information and research, the Board is constantly in a position to consider the need for modifications to the Code and to conduct a more general review of the entire Code if required.

The Board has no supervisory or adjudicative role regarding individual companies' application of the Code however. Ensuring that companies apply the Code in accordance with stock exchange regulations is the responsibility of the respective exchanges. The role of evaluating and assessing companies concerning which rules they comply with and which they do not, however, belongs to the actors on each capital market. It is the company owners and their advisers who ultimately decide whether a company's application of the Code inspires confidence or not, and how that affects their judgement of the company's shares as an investment.



The work of the Corporate Governance Board during the year

The composition of the Board remained unchanged since the previous year. The Chair was Hans Dalborg, Deputy Chair was Lars Otterbeck and other the members were Lars-Erik Forsgårdh, Kerstin Hessius, Leif Lindberg, Anders Malmeby, Marianne Nilsson, Marianne Nivert, Michael Treschow and Anders Ullberg. Jukka Ruuska, a co-opted member since the Board was formed, left during the spring of 2008 when he left his post at OMX Nordic Exchange. The Secretary was Per Lekvall, who was also responsible for the Board's office functions, and Lars Thalén acted as a consultant and adviser on information issues.

The Board held twelve meetings during the year, the majority of which were devoted to the work of revising the Code. A number of issues concerning the Board's normal activities were also dealt with.

The Board's work during the year is summarised below.

Review of the Code

At its meeting on 6 September 2007, the Board decided to conduct a review of the Code with the object of broadening its scope to cover all Swedish companies with shares listed on a regulated Swedish market. The aims of the review were to eliminate obvious weaknesses and difficulties that had been discovered in the existing Code, to simplify and adapt the Code to the conditions of smaller listed companies without compromising existing standards of good corporate governance, and to ensure that changes to the Code would simplify – or at least not obstruct – harmonisation of corporate governance rules in the Nordic region.

To aid this work, representatives of the stock exchanges concerned were co-opted to the Board: Anders Ackebo from OMX Nordic Exchange and Björn Wallin from NGM Equity. In addition, a working group was set up, consisting of Board Secretary Per Lekvall, Board members Leif Lindberg and Anders Malmeby, and three independent experts – Thomas Halvorsen, Björn Kristiansson and Rolf Skog. The Board held a total of ten meetings devoted to the review of the Code, and the working group held several further meetings and discussions.

A proposal for a revised Code was developed during autumn 2007. The proposal was the result of a number of surveys and other systematic follow-up methods used by the Board since the introduction of the Code, as well as opinions and experiences of practical application of the Code gathered at various seminars and conferences organised by the Board. The Board also conducted a special survey into how the Swedish form of nomination committee has been applied and has worked at the companies.[1)]

Additionally, an open invitation was issued to all interested parties to provide opinions and suggestions regarding the review of the Code, both on the Board's website and directly to the companies concerned and capital market actors. Around fifteen responses were received, and these were extremely valuable contributions. They varied greatly in character, from brief messages saying that the Code was working well and should be changed as little as possible to extensive and well formlated suggestions for improvement.

The proposed revised Code was published on the Board's website on 1 February 2008. At the same time, information was sent to the media, as well as to the companies concerned and capital market actors, along with an open invitation to offer opinions and comments no later than 28 March 2008. Around twenty responses were received during this period. On 20 February 2008, the Board arranged a well-attended "user conference", aimed particularly at the new Code companies, to discuss the proposal and seek opinions. The Board Secretary and members of the Board also participated in various other seminars and conferences at which the proposal was discussed.

On the basis of the comments received and other relevant information, the Board made its final adjustments to the proposal, before presenting the final version on its website on 7 May 2008, along with a document providing a detailed comparison with the previous version of the Code. The revised Code was then printed and distributed to the companies concerned, capital market actors and a number of other stakeholders. An English translation of the Code and the comparison document are available on the Board's English language website.

How the Code is applied in practice

As in previous years, the Board carried out a number of investigations into different aspects of how the previous Code had been applied. The Board aims to conduct such

[1)] The results of this survey are summarised elsewhere in this annual report. The entire report can be found on the Board's website.

surveys regularly and, as far as possible, using identical methods each time. Therefore, although absolute values for individual variables always contain a significant element of uncertainty in these types of survey, it is possible to identify trends with greater confidence.

The most important recurring survey is the analysis of companies' descriptions in their corporate governance reports of how they apply the Code. The Board has now performed this analysis three years in a row. To complement this, the Board has also analysed the companies' reports on internal controls. The results of both these investigations can be found later in this annual report, in the section Corporate Governance in Sweden 2007–2008.

In addition, members of nomination committees who were appointed for the 2007 annual general meetings were interviewed in a special survey aimed at providing a clearer picture of how the Swedish model of nomination committee has worked in practice. A summary of the most important results appears elsewhere in this annual report, and the entire report can be found on the Board's website.

Finally, the Code Barometer will now be conducted every second year rather than annually as before. The next such survey is planned for autumn 2008 and will be summarised in the 2009 annual report.

Information on Swedish corporate governance

An important aspect of the Board's work is to promote increased awareness and understanding of Swedish corporate governance in international capital markets.

As part of this work, the board has published another information pamphlet in English. Entitled Discharge from liability in the Swedish listed company, it was written by Carl Svernlöv, a lawyer, and is based on the doctoral thesis he presented at Stockholm University in spring 2007. It succinctly describes an aspect of Swedish corporate governance which is puzzling to many foreign observers, and it has been welcomed by the non-Swedes in the Board's network of contacts. The document can be ordered or downloaded free of charge from the Board's website.

Through its secretariat, the Board has regular contact with various actors on the international capital markets and with equivalent corporate governance code organs in other EU member states. During the year, the Board was also invited to present and discuss Swedish and Nordic corporate governance at a number of international conferences.

Nordic harmonisation

As reported in the Board's previous annual report, discussions with other Nordic countries about the possibility of harmonising rules and norms for corporate governance are under way. This would have great advantages, not only for practical reasons for those companies with operations in more than one Nordic country, but also to provide a more integrated Nordic capital market and to give the countries a stronger, more unified voice within the EU and in other international forums.

These discussions continued through the year and a number of meetings were held. As a first step, the focus is to compile the key principles that are common to corporate governance in the Nordic countries in order to provide a basis for evaluating the possibilities of pursuing some form of harmonised framework of norms. It is still too early to predict the results of these discussions.

The Board's comments on proposals referred for consideration

In addition to its normal work and role, the Board is asked to provide comments and opinions on proposals for legislation and to government inquiries and investigations within the field of corporate governance. During the year, the Board was asked to comment on three matters. Its responses are summarised below, and the complete texts are available on the Board's website.

Swedish Government Official Report (SOU 2007:56) on audit committees etc; implementation of the 2006 Statutory Audit Directive, (interim report, September 2007)

This interim report, which forms part of the Official Report on audits and auditors, concerns issues such as how the directive's provisions on audit committees are to be implemented in Sweden. The report states that it should be possible to implement the provisions of the directive through self regulation, (the Code), and recommends such a solution, but also states that this assumes that the Code be applicable to all companies listed on regulated markets. As the Swedish Code of Corporate Governance at the time of the report was only applicable to around a hundred of the largest companies on the stock exchange, the report was forced to propose that the directive's provisions on audit committees be implemented through legislation.

In its comments on the report, the Board emphasised the importance of preserving the Swedish model of self regulation, and highlighted the risk that the Code would lose its "critical mass" if major issues were successively passed over into legislation. The Board also stated that it had decided to conduct a full review of the code with a view to expanding its scope to cover all companies listed on regulated markets from 1 July 2008, meaning that the obstacle to regulating the provisions of the directive through the Code would no longer exist by the time the provisions were to be implemented.

The Board stated its intention to formulate the Code's rules on audit committees in line with the report's proposals if it was found that implementation through the Code were possible. The Board was, however, critical towards one point in the reports proposals, namely that on the subject of the directive's requirement that one member of the committee must have particular "accounting or auditing competence". The Board highlighted the risk that this would, albeit unintentionally, affect the balance of responsibility within audit committees – and therefore the entire board – in that the individual specified as especially competent would bear a greater responsibility than the other members. The Board therefore recommended a solution based more on the intentions of the directive than its wording, namely that the competence requirement be applied to the committee as a whole.

The legislative work on this issue began at the Ministry of Justice in autumn 2007, and some doubts have now arisen concerning the possibility of implementing the directive's provisions on audit committeesthrough self regulation. The Board has informed the Ministry that if self regulation is deemed unworkable then it should as far as possible be left to the individual company to decide whether the tasks of the audit committee should be carried out by a separate committee or by the entire board of directors. Unlike in British and American companies, which normally have a large proportion of executive directors, the existence of a separate committee to perform these tasks within a Swedish board is more a question of efficient and effective organisation of the work of the board rather than an issue of the board's integrity towards the executive management. The Corporate Governance Board feels that the introduction of rules to regulate board efficiency into the Companies Act would go against the principles of the Act and involve a level of detail that is unfamiliar in Swedish corporate law. The Board therefore recommends that the possibility to allow the individual company to decide whether an audit committee's tasks are to be carried out by a separate committee or, subject to certain conditions, by the entire board of directors, which the Board believes is allowed by the directive, should be utilised in full.

Ministry of Justice Memorandum Ds 2008:5 on changes in the EC audit directive

This memorandum contains the Ministry's proposed legislation for the implementation of the EU directive on changes to the fourth and seventh directives on companies, which contains a legal requirement for companies listed on a regulated market to produce a corporate governance report, including a description of the company's internal control systems.

On this issue, the Board also recommends self-regulation, and if this is not possible, the Board suggests regulation at the lowest possible extent allowed by the directive. In particular, the Board feels that a legal requirement to produce a report on internal controls, which must be reviewed by the auditor and which contains the threat of

liability for damages, may prove counter-productive as it gives companies an incentive to minimise the information they provide, which would be a backward step for Swedish corporate governance compared with the current situation, which is based on the Code's regulation of this issue.

Further, the board feels it is inappropriate to stipulate that the corporate governance report must be a part of the formal annual report, something that is proposed in the memorandum but not required by the directive. Such a stipulation would lead to a demand for an auditor review of the entire corporate governance report, which in turn may inhibit companies' willingness to provide detailed reports, as well as imposing stricter audit review requirements on Swedish companies than on companies in other EU and EES countries.

The Board also feels, contrary to the proposals in the memorandum, that it is sufficient that a company makes its corporate governance report available on its website, and that a group of companies should be allowed to include its description of internal controls for the whole group and the parent company in its corporate governance report.

Swedish Government Official Report (SOU 2008:32) on the removal of the audit requirement for small companies, (interim report, April 2008)

This is the second interim report from the Government Committee on Auditors and Auditing. It concerns a proposal to abolish the audit requirement for small companies. It includes a proposal to abolish management audits, meaning that auditors would therefore no longer be required to recommend whether members of the board of directors and the chief executive officer should be granted discharge from liability. The report does not, however, provide an analysis of, or any proposals regarding the practice of discharge from liability, as this issue is being investigated by another government committee.

The Board does not offer an opinion on whether the management audit should be abolished, as it believes that this issue cannot be examined without first deciding whether the concept of discharge from liability has a place in Swedish company law. If, as the committee proposes, the annual general meeting is to decide on the issue of discharge from liability "on the basis of the information provided by the board of directors in the annual report and at the annual general meeting", this means in practice that the directors in question would be providing the annual general meeting with the information which is to form the basis for the decision on whether to grant them discharge from liability. The Board feels that this risks undermining the value of any decision on discharge from liability.

The Board therefore believes that the concept of discharge from liability should be investigated, and if the conclusion is that the practice should be abandoned then the practice of auditing the management can also be abandoned.

A revised Swedish Code of Corporate Governance

As of 1 July 2008, Sweden has a revised code of corporate governance, applicable to all Swedish companies listed on regulated Swedish markets. This has broadened the scope of the Code from around a hundred companies to over three hundred.

In brief, the main reasons for the Board's decision to review the Code in order to broaden its scope are as follows:

- By the end of corporate governance year 2007–2008, the original Code had been in place for three years, and experience of its practical application had been mostly positive. After some initial problems, some of which were addressed by Board instructions and others by companies themselves developing and adapting their practices and routines, the Code was doing its job and making significant contributions to the further improvement of corporate governance in Sweden. The Board therefore felt that it was time to broaden the scope of the Code in line with the original intentions of the Code group, was the joint government – private industry working group responsible for developing the original version of the Code.

- Sweden was one of few countries in the European Union whose national corporate governance code was not applicable to all companies listed on its main stock exchange. The risk was that international actors might therefore have an inaccurate view of Swedish corporate governance, and the Board could find no justification for the Code not being applicable to all stock exchange listed companies. Good corporate governance is every bit as important for small companies as for larger ones, and unless a corporate governance code requires unreasonable administrative demands on companies, there is no long-term reason why the same norms should not apply to all listed companies.

- One of the aims of self-regulation is to avoid the need for extensive and detailed legislation on issues that are better regulated by the private sector. One area where this is particularly relevant is Swedish implementation of EU regulations, which may allow self-regulation in certain cases, assuming that it applies to all companies listed on regulated markets. If the Code is to provide a realistic alternative to legislation, it must therefore be applicable to more than just the largest companies on the stock exchange.

As previously, the revised Code is based on the comply or explain principle, which means that companies are not obliged to follow every rule in the Code. They are free to choose alternative solutions that they feel are more relevant to their specific circumstances, providing they report any such deviation, describe the solution they have chosen instead and explain their reasons for doing so. The Code therefore prescribes what is generally – but not always – regarded as accepted corporate governance principles. For an individual company, other solutions than those specified by the Code may well provide better governance.

A corporate governance code involves balancing interests which may conflict to a certain extent. On the one hand, the rules should be designed so that compliance can be determined objectively, and they should not include what is already covered by legislation and other regulations; on the other hand, the Code should provide a clear picture of what constitutes good corporate governance at a particular point in time.

The Board has therefore sought to weed out those rules in the previous version of the Code that have not been deemed to add anything substantial that was not already covered by or that overlapped existing legislation and other regulations. At the same time, the Board was keen to preserve the pedagogical role of the Code to ensure that it provides an up-to-date picture of generally accepted principles for Swedish corporate governance, not least for the benefit of the many new, smaller "Code companies".

The revised Code therefore still contains certain rules whose compliance may not be completely objectively verifiable, or whose content may to some extent be covered by existing legislation or regulations, but the Board felt it was important to retain them for their pedagogical value. Of course this does not mean that companies can deviate from corporate legislation or binding stock exchange regulations by invoking the Code's comply or explain mechanism.

The most important changes in the revised Code com-

pared with the previous version are the following:

- The Code has been shortened and simplified without reducing its level of ambition. The number of rules has been reduced from 69 to 42, many of the rules themselves have been shortened and simplified, and a simpler structure has been introduced.

- The role of the nomination committee has been clarified. The committee's sole task is to provide information for the shareholders' meeting's decisions on certain electoral and remunerations issues, (as well as, where applicable, proposing a procedure for the appointment of the following year's nomination committee), and that members of the committee, however appointed, are to act in the interests of all shareholders.

- Certain requirements concerning the independence of nomination committee members have been introduced:
  - The majority are to be independent of the company and its executive management.
  - At least one member is to be independent of the company's largest shareholder or any group of shareholders that act in concert in the governance of the company.
  - If more than one member of the board of directors is on the nomination committee, no more than one of these may be dependent of a major shareholder in the company.

- A new requirement has been introduced that, as well as presenting its proposals regarding the board of directors to the annual general meeting, it must also issue a statement on the company's web site explaining its proposals when the notice of the shareholders' meeting is issued. This statement must also refer to the requirements concerning the composition of the board contained in Code rule 4.1.

- The Code rules on director independence and the number of members of the executive management allowed on the board of directors have been harmonised with the equivalent regulations of the stock exchanges concerned.

- Audit and remuneration committees are no longer obligatory, in as much as their tasks can be performed by the whole board of directors, regardless of the size of the board, providing that no member of the company's executive management participates in this work. [2)]

- A new requirement has been introduced for the company's corporate governance report to include any infringement of the stock exchange rules applicable to the company, or any breach of good practice on the securities market reported by the relevant exchange's disciplinary committee or the Swedish Securities Council during the most recent financial year.

- Requirements on the value of the information included in explanations of non-compliance have been clarified. Companies are now no longer required to simply justify non-compliance with Code rules, but also to describe the alternative solutions they have chosen.

The revised Code is applicable from 1 July 2008. It applies to all companies whose shares are quoted on the OMX Nordic Exchange Stockholm or MGM Equity. Certain transitional rules are also included.

Furthermore, the formal basis for a company's obligation to apply the Code has been changed. Previously, the requirement for certain companies to apply the Swedish Code of Corporate Governance was contained in the regulations of the Stockholm Stock Exchange. From 1 July 2008, it will be considered good stock exchange practice to apply the Code. The companies concerned will therefore be required to apply the Code in accordance with the stock exchange agreements of the relevant exchange.

[2)] Audit committees may become compulsory again for companies over a certain size as a result of the implementation into Swedish law of the European Union's eighth Directive on Companies. Work on this legislation is currently in progress, and the new law is expected to come into force on 1 January 2009. See also the Board's comments on this proposal on page 5.

CORPORATE GOVERNANCE IN SWEDEN 2007–2008

The Board conducts regular surveys to follow up and analyse on a general level how companies apply the Code and to analyse the Code's functionality and its impact on corporate governance in Sweden. The following studies were carried out during the year, and their results are summarised in this part of the annual report.

- **Application of the Code, 2007–2008.** This survey was carried out on the Board's behalf by Nordic Investor Services, and is a follow up to a similar survey carried out last year. It is based on analysis of the corporate governance reports of every Code company and aims to provide a concrete and reliable picture of how the Code has been applied, in order to provide a basis for the board's views on the further development of the Code. The results of this study are presented on pages 10–15, along with a comparison with the results of the surveys carried out in 2005 and 2006.

- **Nomination committees for the 2008 annual general meetings.** This survey was also carried out by Nordic Investor Service, and was a follow-up study of the key aspects of the previous year's equivalent survey. It is an analysis of how nomination committees for the 2008 annual general meetings were appointed and their composition. The results are presented together with the survey on application of the Code described above.

- **Company reports of internal controls.** RThe Code rule on reports on internal controls, (original Code rule 3.7.2), was the one which caused most problems when the Code was introduced. The Board therefore presented a provisional solution for reporting year 2005 that was considerably less strict than the content of the original rule. This solution was made permanent through Board Instruction 1-2006 in September 2006.

Against this background, it was a particular priority of the Board to investigate how this rule had been applied in practice and how well it had worked. This year's survey was carried out on the Board's behalf by Anders Malmeby of KPMG, who is also a member of the Swedish Corporate Governance Board. It is a follow up to the equivalent surveys conducted in 2005 and 2006, and the results are presented on pages 16–18.

- **The work of nomination committees.** As part of its preparatory work before the formal review of the Code, the Board commissioned a survey on how the Swedish nomination committee model has worked in practice. The survey consisted of interviews with a number of nomination committee members from a broad spectrum of companies.

  The survey was conducted by Malin Björkmo, the former head of the Division for State Enterprise at the Ministry of Enterprise, Energy and Communications, who has considerable personal experience of chairing and membership of nomination committees of stock exchange listed companies. The entire report is available on the Board's website, and a summary of the most important results can be found on pages 19–21 of this annual report.

Application of the Code, 2007–2008

Summary

The previous annual report stated that the Code had achieved broad acceptance among companies after two years of practical application, and that it had been applied in the ambitious yet flexible manner that had been intended. This view remains and is reinforced by the 2007 survey. Over 40 per cent of companies have complied with every rule in the Code, and only four companies out of 106 have reported non-compliance with more than two Code rules. At the same time, companies have continued to show that they apply the Code with the flexibility intended and are not afraid to deviate from the Code and to provide relevant explanations where they judge it appropriate.

As in previous years, the area in which most companies have chosen alternative solutions is that of the composition of nomination committees. This applies particularly to companies with a concentrated ownership structure who, in many cases, have prioritised opportunities for major owners to sit on the board, sometimes as chair, even if this has meant some non-compliance with the Code's rules on the composition of nomination committees. The second most common area of non-compliance is the rules on audit and remuneration committees, where the alternative has usually been that these issues have been dealt with by the whole board or that companies have prioritised competence and experience over committee members' independence. Together, these three rules account for almost two thirds of all reported instances of non-compliance.

Last year's report named the quality and information value of explanations of reported non-compliance as the area where he Code had worked least well thus far. This year has seen considerable improvement on that point, though there is still room for further improvement in this crucial area.

There is broad support among Code companies for the concept of the nomination committee as a forum for a structured, owner-led process to prepare for the annual general meeting's election of board members and auditors. There are still a small number of companies that do not find it necessary to appoint a nomination committee, but the majority apply this model, as do many companies that have not been formally obliged to apply the Code.

Four out of five nomination committees are appointed based on the annual general meeting's decision on the procedure for appointing the committee rather than being appointed at the annual general meeting itself. This proportion has been fairly constant during the three years that this survey has been conducted.

Swedish nomination committees are dominated by representatives of the companies' major shareholders, especially Swedish institutional owners. Just 15 per cent of members of nomination committees have no express link with their companies' owners, and nine nomination committee chairs of ten represent a shareholder.

Nomination committees' knowledge of the work of the board and company strategy, and consequently the requirements concerning the composition of the committee, has sometimes been called into question in the general debate surrounding these issues. Nevertheless, the possibility allowed by the Code for up to half of the members of the committee to be members of the board is little used. Of an average of 4.5 committee members, most nomination committees contain no more than one member of the company board, and this is usually the chair of the board.

Aims and methods

The aim of analysing how companies apply the Code is to provide information in order to assess how well the Code works in practice, and to see whether there are aspects of the Code that companies find irrelevant, cumbersome or in some other way unsatisfactory. The results provide a basis for the continued improvement of the Code.

The main basis for the study is companies' own descriptions of how they have applied the Code, partly in the corporate governance reports that the Code requires them to submit together with their annual reports, partly in the minutes of annual general meetings, on their websites etc, and partly, if required, by gathering complementary information directly from the companies. Those included in the 2007 study were the 115 companies that were registered as Code companies on the OMX Nordic Exchange Stockholm as of 1 February 2008. Publishing deadlines meant, however, that it was not possible to await every company's report, so the analysis of corpo-

rate governance reports is limited to the 106 companies whose reports were available as of 25 April 2008, while the study of nomination committees covers a further three companies.

Corporate governance reports

Rule 5.1 of the original Code states "A special report on corporate governance is to be attached to the company's annual report." It does not need to be reviewed by the company's auditors, but the report should state whether this is the case or not. The corporate governance report is to state that the company applies the Swedish Code of Corporate Governance and describe how it has been applied during the most recent financial year. Any non-compliance with individual rules is to be reported and justified.

All but two of the companies surveyed submitted a formal corporate governance report. Of these two, one became a Code company during the year, while the other included a short section on corporate governance in its statutory director's report, which is not regarded as compliance with the Code's requirement to produce a corporate governance report. In both these cases, the Code has therefore not been applied correctly. No similar cases were registered in the two previous years.

Original Code rule 5.1.2 requires companies to state in their corporate governance reports that they had applied the Code. Of the 104 companies that produced corporate governance reports, 94 included such a declaration, while the remaining ten, as well as the two companies that did not produce corporate governance reports, neglected to do so. [1)] In each case, however, it was implicit that the Company had applied the Code.

The Code does not require that the corporate governance report be reviewed by the company's auditors, but the report should state whether this is the case or not. All but three companies, (plus the two that did not submit a corporate governance report), state this clearly. The reports of four companies were reviewed by the auditors, i.e. 4 per cent. The corresponding figure for 2005 was 9 per cent, and for 2006 it was 5 per cent, so companies seem less interested in having their corporate governance reports reviewed by auditors than when the Code was introduced. [2)]

Companies that apply the Code are not obliged to comply with every single rule contained in the Code, and are free to choose alternative solutions providing each case of non-compliance is clearly described and justified. Table 1 shows that 63 of the 103 companies studied in 2007 chose an alternative solution to one or more Code rules. Almost all companies gave clear explanations of their alternative solutions, while in two cases, the explanations could only be read between the lines of the corporate governance report. The corresponding figures for 2005 and 2006 were six and one respectively. The majority of companies list their explanations in a separate section of the corporate governance report, with the rest providing their explanations in the relevant parts of the report.

The corporate governance report is to contain a separate section describing how the company's internal controls are organised and, if no internal audit function exists, the reasons for this. The application of these rules was analysed separately and is reported elsewhere in this annual report.

Table 1. How is non-compliance reported in corporate governance reports?

	No. of companies			Per cent		
	2007	2006	2005	2007	2006	2005
Full compliance	43	33	18	41%	36%	24%
Non-compliance reported in a separate section	21	21	20	20%	23%	27%
Non-compliance reported in the introduction	25	26	19	23%	29%	26%
Non-compliance reported in the relevant part of the text	15	10	11	14%	11%	15%
Non-compliance reported between the lines	2	1	6	2%	1%	8%
Total	106	91	74	100%	100%	100%

[1)] The proposed legislation concerning the implementation of changes to the EU's fourth and seventh directives on companies contains a statement to this effect. See Ministry of Justice Memorandum Ds 2008:5.

[2)] The proposed legislation mentioned in the previous footnote contains a proposal that the mandatory corporate governance report be included in the annual report, which would mean that it must be reviewed by the company's auditors. The Board is opposed to this idea. See the Board's comments on this issue on page 6.

How companies applied the rules of the Code

As shown in Table 1, 43 companies, or over 40 per cent of the companies surveyed, chose to comply with every rule in the Code in 2007. The figures for 2005 and 2006 were 24 and 36 per cent respectively, showing an upward trend of the percentage of companies choosing to apply the all the rules of the Code.

Diagram 1 shows how the number of reported cases of non-compliance has changed during the three years the Code has been in place. [3] There has been a slight increase in the number of companies reporting one or more deviations from the Code, meaning a percentage decrease from 76 per cent in 2005 to 59 per cent in 2007. The number of reported instances of non-compliance has also fallen considerably in relation to the number of companies surveyed, from over two deviations per company in 2005 to less than one per company in 2007. The number of rules showing non-compliance has been fairly constant during the past two years. The higher figure for 2005 is partly a result of disagreement about the interpretation of some of the rules during the first year of the Code.

It should be emphasised in this context that the Board does not have as a goal that as many companies as possible comply with every rule of the Code. On the contrary, the Board regards it as a key principle that the Code be applied with the flexibility originally intended by the concept of comply or explain. Otherwise, the Code runs the risk of becoming mandatory regulation, thereby losing its role as a set of norms for good corporate governance at a higher level of ambition than the minimums stipulated by legislation. It is the Board's firm belief that better corporate governance of individual companies can result from other solutions than those specified by the Code.

Diagram 2 shows the number of companies that have reported different numbers of cases of non-compliance each year. Here it is also important to bear in mind that the number of companies surveyed has varied from year to year. As mentioned previously, 43 companies, around 40 per cent of those surveyed, reported no instances of non-compliance in 2007. Most of the remaining 63 companies reported one or two deviations from Code rules, with only four reporting more than two. In general, the trend is towards fewer instances of non-compliance.

Which rules do companies not comply with?

Diagram 3 shows the distribution of non-compliance among the rules of the Code. The picture is very similar to that of previous years, with the five rules deviated from most being the same as the previous year. The rule with most instances of non-compliance in 2007 was original Code rule 2.1.2, concerning the composition

Diagram 1. Number of reported cases of non-compliance

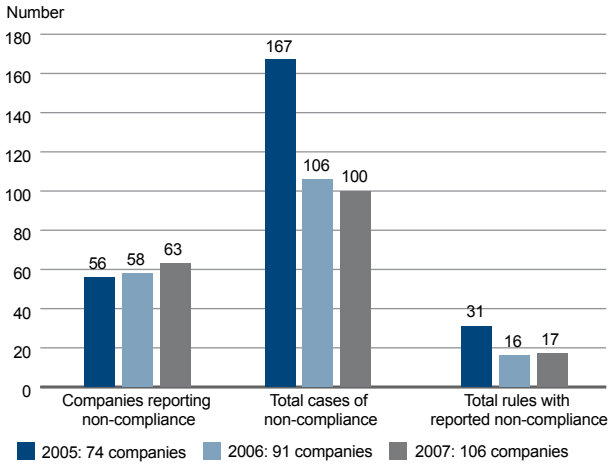
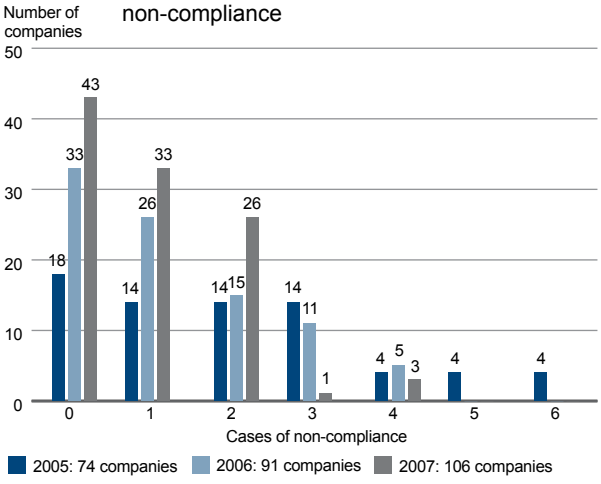


Diagram 2. Number of companies per number of cases of non-compliance



[3] N.B. The figures shown are absolute and must be read in the context of the number of companies surveyed each year to enable comparison between different years.

of nomination committees. Primarily, non-compliance with this rule was reported by companies with concentrated ownership, where the annual general meeting has found it appropriate to appoint one or more major shareholders to the committee, in some cases as chair, even though this is in breach of the Code. Other explanations for non-compliance with the Code's requirement that members of the board are not to form the majority in the nomination committee are "competence" and "efficiency", and one case where a nomination committee was regarded as unnecessary in view of the company's ownership structure.

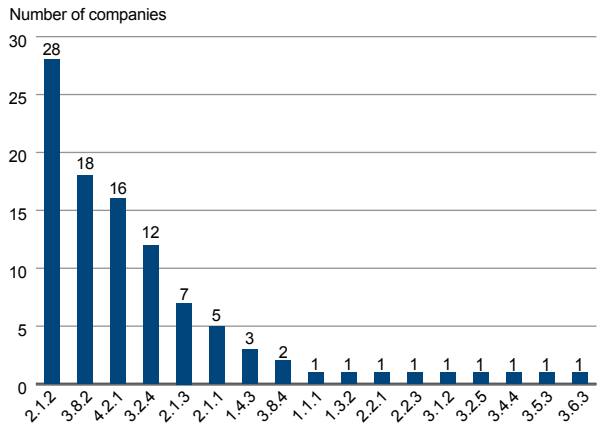
Rule 3.8.2, concerning audit committees, and rule 4.2.1, concerning remuneration committees, accounted for the next largest number of deviations. The most common reason for non-compliance with the rule on audit committees is that the size of the board makes it preferable to allow the whole board to carry out the tasks of the committee. According to Board Instruction 2-2006, such a solution does not require any explanation, but there obviously remain some question marks around the interpretation of this point. [4] Other explanations state "experience", "continuity" and/or "competence" were prioritised above the Code's requirement of independence, particularly concerning members who had passed the 12 year limit for independence with regard to the company and its management. In some cases it has also been regarded as more efficient to have an audit committee consisting of just two members.

The chief reason for non-compliance with the rule on remuneration committees was that the Code's requirement that committee members be independent of the company and its executive management was not fulfilled, often as a result of the 12-year rule. Also here, there are explanations that are not strictly required as a result of Board Instruction 2-2006.

Rule 3.2.4 concerns the requirement that the majority of board members elected by the annual general meeting be independent with regard to the company and its executive management. Twelve companies have reported non-compliance with this rule, usually because one or more members who are regarded as having the appropriate competence and experience to serve on the board do not fulfil the rule's independence criteria because of the 12-year rule.

Rule 2.1.3 concerns the time for the announcement of the composition of the nomination committee, where seven companies have not felt able to do this within the stipulated six month period due to practical reasons, e.g. because the annual general meeting is scheduled for early the following year.

Diagram 3. Cases of non-compliance per Code rule, 2007



Explanations of non-compliance

The quality of explanations of non-compliance is crucial to the success of corporate governance codes based on the principle of comply or explain. The quality of these explanations is for the recipients of the reports to assess, primarily the companies' owners and other capital market actors. In general, in order to fulfil their aims, the explanations should be concrete, informative and based as far as possible on the specific circumstances of the company concerned. Vague arguments and generalisations, without any real connection to the company's situation, have little information value.

As in previous years, an attempt has been made to assess the quality of explanations. This necessarily involves a large element of subjectivity, but as the evaluation has followed the same format and criteria each year, it is at

[4] This is made much clearer in the revised Code, which allows the board of directors, regardless of size, to fulfil the tasks of the audit and remuneration committees providing that no member of the company's executive management participates in the work.

least reasonable to assume that any observed trends are reliable.

In last year's report, the quality of explanations was regarded as the area in which the Code had thus far worked least satisfactorily. This year's results, however, show a marked improvement. As Table 2 shows, the percentage of explanations regarded as having little or no information value has been almost halved from 28 per cent in 2005 to 15 per cent in 2007, while the percentage of explanations with good information value has risen over the same period from 40 to 57 per cent. There is still considerable room for improvement, but the trend is positive.

Nomination committees

As a follow up to last year's analysis of nomination committees, a special survey of the appointment and composition of nomination committees based on the decisions at annual general meetings in 2007 was conducted. It was designed to cover the same 115 Code companies as the previous study, but this year, only 109 were included in the survey, compared with 100 last year. On the issue of how nomination committees were appointed, the companies' 2008 annual general meetings were also studied. The latter studied covered 104 companies.

According to the rules of the Code, companies can choose one of two methods for appointing nomination committees. Committees can either be appointed directly at the annual general meeting or the meeting can decide upon a procedure for later appointment to the committee. As Table 3 shows, the vast majority, (around 80 per cent of companies that appointed a nomination committee during the period studied), chose the second method. This figure has remained fairly constant.

Diagram 4 shows the number of members of each nomination committee that was appointed following decisions at annual general meetings in 2006 and 2007. Six companies did not appoint a nomination committee in 2007, which is two more companies than in 2006. Both of these became Code companies during the year, however, and were not obliged to apply the Code at their 2007 annual general meetings. Additionally, one company had a nomination committee consisting of just two members, which does not fulfil the requirements of the Code.

The study shows that a typical nomination committee has four or five members, with an average figure of 4.5.

A total of 452 people were members of the nomination committees appointed by the surveyed companies' 2007 annual general meetings, compared with 425 members appointed by the 2006 meetings. Of these, 23 per cent

Table 2. The information value of explanations of non-compliance

	Number of companies			Per cent		
	2007	2006	2005	2007	2006	2005
Good	54	48	30	57%	53%	40%
Dubious	30	22	23	28%	25%	32%
Little/None	16	21	21	15%	23%	28%
	106	91	74	100%	100%	100%

Table 3. How are nomination committees appointed?

	Number of companies			Per cent		
Method	2008	2007	2006	2008	2007	2006
Procedure for later appointment	81	85	77	82%	83%	80%
Appointment at annual general meeting	18	18	19	18%	17%	20%
No nomination committee appointed	5	6	4			
	104	109	100	100%	100%	100%

were members of the board of directors, compared with 25 per cent the previous year. The remainder were non-board members, often external shareholder representatives. The percentage of women on the nomination committees increased from 14 to 15 per cent.

Of the 103 nomination committees in 2007, 78 included one member of the board, in most cases the chair of the board, while 19 committees contained no members of the board. Twelve nomination committees included two or three members of the board.

Table 4 shows the owner representation within the nomination committees. The vast majority of committee members represented Swedish owners, mostly Swedish institutional investors. This is a further increase on last year's figure, while the proportion of foreign shareholders' representatives declined somewhat. The group consisting of non-shareholder representatives, i.e. members of the board and other individuals with no known link to the company's shareholders, almost halved over the same period.

Table 5 shows the links that nomination committee chairs had to their company's owners. Almost three quarters of all nomination committee chairs represented major shareholders, which is a clear increase compared with the previous year. If the 16 companies whose chair of the board, usually a large private shareholder, was appointed chair of the nomination committee are also included, then almost 90 per cent of nomination committee chairs were shareholder representatives. This latter group did not comply with the Code rule on chairs of nomination committees, a deviation that occurs most frequently in companies with dominant private shareholders.

Diagram 4. Size of nomination committees

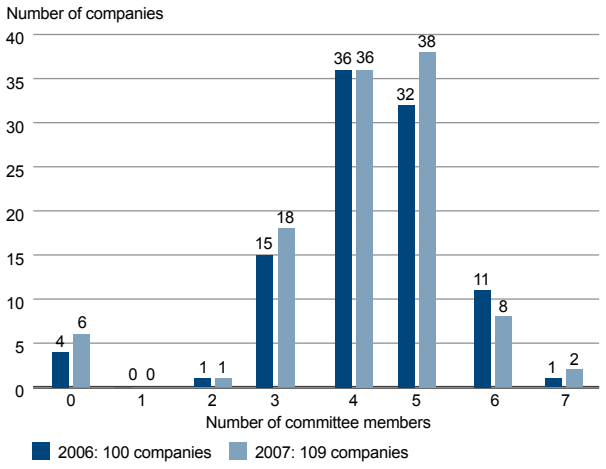


Table 4. Owner representation on nomination committees

	Number of companiesr		Per cent	
	2007	2006	2007	2006
Representative of Swedish shareholder	342	261	76%	62%
Representative of foreign shareholder	42	48	9%	11%
Not shareholder representative	68	116	15%	27%
Total	452	425	100%	100%

Table 5. Chairs of nomination committees

	Number of companies		Per cent	
	2007	2006	2007	2006
Shareholder representative	75	61	73%	64%
Member of the board	10	17	10%	18%
Chair of the board and shareholder representative	16	13	15%	14%
Other	2	4	2%	4%
Total	103	95	100%	100%

Company reports on internal controls[1)]

Summary

How have companies that are obliged to apply the Code reported on their internal control function for 2007? What changes have taken place since the 2006 reports?

- One company in three ran specific projects to develop their internal control function during 2007. This signals a high level of ambition and equates with the situation the previous year.
- Sixteen companies, or fifteen per cent, failed to apply the Code correctly by breaking Code rule 3.7.3, which requires companies to justify their decision if they have chosen not to have a special internal control function, i.e. internal audit. These companies did not comment on this point, nor did they mention this non-compliance in their corporate governance reports.
- Of the large companies, seven of ten were considered to have a high level of ambition in their reporting, a figure similar to that of the previous year.
- The level of ambition among medium sized companies was evenly spread between those with high, medium and low levels. This was less good than in 2006, and largely attributable to new Code companies. In absolute terms, the number of medium sized companies with a high level of ambition was unchanged.
- Around half of large companies and just under a third of all other companies used the international framework for internal controls, COSO. A previously, in most cases, the report structure followed the recommendations issued by the Confederation of Swedish Enterprise and the Swedish Institute of Authorized Public Accountants.
- The corporate governance report of just one of the 106 companies surveyed was reviewed by the company's auditor. This particular report was included as part of the company's formal annual report.
- Corporate governance report sections on internal controls were usually around one page, with the most detailed being two and a half pages. This was more or less the same as the previous year. Bearing in mind that content is considerably more important than size, those companies with more ambitious reports usually produce reports on internal controls that are around two pages long.

The survey

The aim of the survey was to examine how companies applied the Swedish Code of Corporate Governance rules concerning boards' reports on internal controls regarding financial statements in 2007. It is a follow up to similar studies for 2005 and 2006.

Companies that are covered by the Swedish Code of Corporate Governance must, from the financial year 2005, submit an annual report on internal controls regarding financial reporting. As stated in the Code and Board Instruction 1-2006, the report is to describe how these controls are organised and be based on the guidelines issued by the Confederation of Swedish Enterprise and the Swedish Institute of Authorized Public Accountants. The report does not need to contain a statement on how well the internal control function has worked during the financial year. The report is to be included as a separate section of the corporate governance report. Auditor review is optional, but the report is to state whether or not this has taken place. If the company does not have an internal control function, (internal audit), the Code states that the board must evaluate the need for such a function annually. The report on internal controls must then include an explanatory statement from the board on the outcome of this evaluation.

Those included in the study were the 115 companies that were registered as Code companies on the Stockholm Stock Exchange at the end of 2007. Publishing deadlines meant, however, that it was not possible to await every company's report, so the analysis of corporate governance reports is limited to the 106 companies whose reports were available as of the end of April 2008. Where applicable, companies have been divided below according to whether they are listed as "large companies" or "medium sized companies" on the Stockholm Stock Exchange. For practical reasons, a small number of "small companies" was also included in the latter category.

[1)] This survey was conducted on behalf of the Swedish Corporate Governance Board by Anders Malmeby, a chartered accountant at KPMG and a member of the Board.

Detailed results

Reports on internal controls

All but two of the companies surveyed in 2007 submitted reports on internal controls. The two that did not submit reports are new Code companies and did not apply the Code for the whole of 2007. See Table 1.

Report structure

In most cases, the structure of the reports followed the recommendations issued by the Confederation of Swedish Enterprise and the Swedish Institute of Authorized Public Accountants. This makes for easier reading of individual reports, as well as easier comparison of the reports of different companies. See Table 2.

Quality statements

Following Board Instruction 1-2006, issued in September 2006, the reports do not have to include a statement on how well the internal control functions have worked during the financial year. One company chose to include what can be interpreted as a quality statement by reporting that the company "...currently has a good internal control function...".

COSO, The international framework for internal controls

The percentage of companies that stated explicitly that they use the internationally recognised framework for internal controls, COSO, remained unchanged. See Table 3.

More information on COSO can be found in the recommendations issued by the Confederation of Swedish Enterprise and the Swedish Institute of Authorized Public Accountants in October 2005. [3)].

Assessment of the need for an internal audit function

Most of the companies that do not have an internal audit function assessed the need for such a function and included a statement in the corporate governance report explaining the board's decision, as required by Code rule 3.7.3. Sixteen companies, (fifteen per cent of those surveyed), did not include such a statement, nor did they

Table 1. Reports on internal controls

	Large companies		Medium sized companies		Total	
	Number	%	Number	%	Number	%
Number of companies surveyed, 2007	59	56	47	44	106	100
Number of companies surveyed that submitted reports on internal controls	59	57	45	43	104	100

Table 2. Report structure

	Large companies		Medium sized companies		Total	
	Number	%	Number	%	Number	%
Companies that followed the recommended report structure, 2007	49	83	35	78	84	81
Companies that followed the recommended report structure, 2006	47	84	29	83	76	84

Table 3. Companies using COSO

	Large companies		Medium sized companies		Total	
	Number	%	Number	%	Number	%
Companies that state they used COSO, 2007	30	51	12	27	42	40
Companies that state they used COSO, 2006	26	26	10	29	36	40

[2)] Board reports on internal controls regarding financial reporting, guidelines on the Swedish Code of Corporate Governance, issued by working groups at the Confederation of Swedish Enterprise and the Swedish Institute of Authorized Public Accountants, 17 October 2005.

mention this as an instance of non-compliance with the Code or explain it. These companies did not therefore apply this Code rule correctly. The corresponding figure for 2006 was three companies.

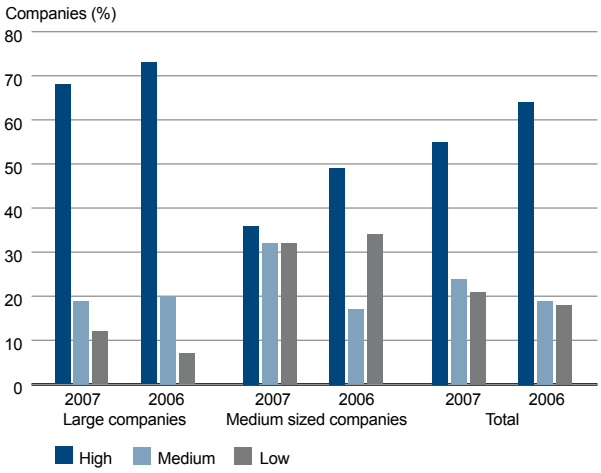
Level of ambition

The survey assesses companies' levels of ambition when reporting on internal controls. The reports have been divided into three categories: Low, Medium and High. The reports in the High category are characterized by detail, substance, transparency and clear reference to the company's operations. Reports in the Low category are brief and contain information of a highly standardized nature.

Assessment of such criteria necessarily contains a degree of subjectivity, and this should be considered when evaluating the precision of the results. The diagram compares the results with assessment of the previous year's reports based on the same criteria.

As the diagram shows, the level of ambition is somewhat less high than in 2006, chiefly among medium sized companies. To a large extent, this can be explained by the addition of new Code companies during the year.

Levels of ambition when reporting on internal controls



The work of nomination committees[1)]

Background and aims

Swedish nomination committees are unique in an international context. The Code's rules on appointment to nomination committees and their tasks serve to clarify the Swedish model, in which shareholders elect a board of directors which in turn appoints a chief executive officer. The shareholders appoint a nomination committee to aid the annual general meeting's decisions on the composition and remuneration of the board of directors, and it is to the shareholders that the committee presents its proposals. In most other countries, particularly in the Anglo-Saxon countries, the tasks of the Swedish nomination committee are carried out by a sub-committee to the board of directors. When the Swedish Code of Corporate Governance was presented, it was perhaps the rules concerning nomination committees that were the greatest corporate governance innovation.

As part of its work to follow up how the Code is applied, the Board commissioned a detailed survey in 2007 to examine the work of Swedish companies' nomination committees. The main purpose was to provide background information in preparation for the review of the Code and the extension of the scope of the Code to include all companies listed on Swedish regulated markets.

Method and selection

In all, 28 people were interviewed. The interviewees were involved in board recruitment at 80 stock exchange listed companies in 2007, of which 22 were not covered by the Code. Nine of the companies had a stock market value of less than SEK 1 billion. The interviewees represented different types of shareholder: large institutions, such as pension funds and life insurance companies; funds with active investment policies; large industrial shareholders; founders; main shareholders etc. The group included several people who had chaired nomination committees. Some of the interviewees were responsible for governance issues at large institutions and had experience of sitting on up to ten nomination committees at a time, while for others, nomination committee work was secondary, though important, alongside their main occupations.

The survey took the form of interviews based on a set of questions. The questions touched on how nomination committees were appointed, but the main focus was on how the committees worked and whether interviewees felt it possible to guarantee the quality of the proposals presented to annual general meetings. The main aim was to identify any particular problem areas.

Results of the survey

The structure of the survey does not enable any quantification of the responses, but the key information revealed by the interviews is summarised in this brief report.

Perhaps the most important result of the survey is that there was a unanimously positive view of nomination committees among the interviewees. The rules of the Code were felt to have contributed to improved quality and structure in the work of recruiting new board members. The survey showed no real problems concerning the Code's rules regarding nomination committees.

Nor did the interviewees see any problems linked to extending the Code rules to cover smaller companies. On the contrary, several people highlighted the need for better quality in the recruitment of directors to boards of small companies and the importance of safeguarding the interests of small shareholders. Also, many small companies already have nomination committees.

While the rules of the Code themselves were not regarded as problematic, there was criticism of how companies apply them. Almost all agreed that the work of nomination committees had not gone well immediately after the Code's introduction, that things had improved steadily and that there were still problems. The most important criticism concerned the quality of the work of nomination committees. Many interviewees emphasised that the competence of individual committee members and continuity in committee work were essential if nomination committees are to carry out their tasks in a professional manner, while noting that there were worrying shortcomings in these areas.

The competence of individual committee members was often felt to be insufficient. Many committee members lack the kind of experience of board membership, executive management or industrial operations that

[1)] This survey was carried out by Malin Björkmo, who also wrote this summary. The full report is available on the Board's web site.

is necessary for carrying out the work of a nomination committee. Furthermore, the committees often have insufficient knowledge about the company itself and the existing board. It was also felt that committee members sometimes lack integrity and commitment. A number of interviewees felt that these problems might be a result of institutional investors not always having clear objectives for their ownership.

Many interviewees felt that the work of nomination committees often gets going too late in the autumn to guarantee a sufficiently good process, which exacerbates the effects of any lack of experience and competence. There is not enough time to carry out the necessary work, which creates time pressure in the recruitment process. This is increased by the fact that many committee members sit on several nomination committees.

Continuity can be crucial to the quality of the results of the work of nomination committees. A "new" committee is appointed every year by the annual general meeting, and the committee prepares nomination proposals for the next annual general meeting. It may be desirable that nomination committees take a longer-term view of board nomination issues, which would be easier if the same committee could continue its work over a number of years. It is particularly common that there are big changes from year to year in companies with diversified ownership, which has negative effects on quality and continuity.

A number of interviewees felt that the chair of the board is far too dominant on nomination committees. Time pressure, a lack of competence and integrity among other committee members and a lack of continuity are contributing factors, and it was felt that such conditions also make it difficult to replace the company chair on the committee.

Many felt that most of the problems revealed by the survey could be solved, or at least eased, if nomination committees were appointed at the annual general meeting. The Code states that a nomination committee may be appointed directly by the annual general meeting or that the meeting may decide on a procedure to appoint the committee at a later date. Most companies prefer the latter model, which normally means that the largest shareholders appoint representatives, often in late August or September.

The advantage of this model is that appointment of the committee at a later stage is likely to provide a more accurate picture of the ownership structure at the next annual general meeting.

It does, however, have several disadvantages. The work of the committee starts late, with all the problems that entails. This model also risks resulting in a lack of continuity and perhaps less commitment than would be the case if the committee members were appointed by name at the annual general meeting. This procedural model can also mean that the composition of the committee is not the best possible, but rather a group of representatives of the largest shareholders who see their assignment as pursuing the best interests of "their" owners rather than those of the company and of all shareholders. All of this ought to mean that shareholders will try to appoint nomination committees at the shareholders' meeting in future.

In conclusion, it is clear that the Swedish nomination committee model gives shareholders greater influence over the composition of the board of directors and is therefore an important instrument for providing conditions for company growth and development. The instrument must be used wisely, however, if the desired results are to be achieved. This will be a particular challenge for increasingly large institutional investors, which may not have the same prerequisites for nomination committee work as industrial owners. Poor nomination committee work can have major consequences for the company, its shareholders and society as a whole.

DOES SELF-REGULATION STAND A CHANCE

A discussion arranged by the Swedish Corporate Governance Board between the Swedish Minister for Justice, Beatrice Ask, and Anders Nyrén, the chair of the Association for Generally Accepted Principles in the Securities Market.

The Nordic model of self-regulation of the capital markets has major advantages and is something to be proud of. This was a point on which Beatrice Ask and Anders Nyrén could agree whole-heartedly. At the same time, there is a world beyond the borders of the Nordic region that must be taken into account, particularly the European Union, where the current trend is towards regulation through legislation. Much of the discussion came to revolve around this point: How to promote the principle of self-regulation by influencing the work of the legislators and, when legislation is unavoidable, how best to bring the two systems together.

How do the government and business regard self-regulation in principle?

Beatrice Ask: Our fundamental view is that self-regulation is beneficial, at least where it is possible. We can try to resist, but sometimes, due to our membership of the EU, we are forced to do certain things. But we want to allow as much freedom as possible.

Anders Nyrén: The corporate sector's view is a result of the general feeling that self-regulation is a highly efficient and effective way to regulate the market. It is cost effective, provides rapid response and, as the rules are set by the market actors, it is binding in a different way. The Code's comply or explain model can take self-regulation a step further than legislation, which can only set minimum levels.

But as you say, regulation sometimes comes from outside, e.g. EU directives, and this can undermine or limit the role of self-regulation. The principles regarding executive pay are a good example. The Code had hardly been presented when legislation was introduced on the same subject.

Is there concern that legislation will take over, leaving us with a toothless Code and ineffective self-regulation?

BA: It is primarily the areas in which we are governed by European rules that can cause problems. I therefore believe that there is good reason to work preventively to ensure the best possible standard of EU regulations and that the business community, the government and parliament must go hand in hand in order to be a the forefront both in Europe and internationally. We are also quite good sometimes, and have actually achieved some victories.

AN: We have achieved some victories, and we have worked well together to defend the Nordic ownership model of A and B shares. But we have a common challenge in that EU legislation is very much based on central European traditions, while self-regulation has grown within a Nordic tradition based on a British model, and we are in a minority when it comes to these issues. If we take the Code as an example, it is vital that we resist the political currents in Brussels that are striving for a common EU code, or even legislation. The Code is an expression of generally accepted principles in the market, a code of conduct adapted to our ownership circumstances and

our capital markets, which can vary greatly from the situation in, say, Germany, France or Holland.

BA: That's correct, and right now we have a great opportunity, for the simple reason that the EU has taken some important steps to simplify its administrative regulations. We must take this opportunity and show the alternatives to regulation. But the business community and your various collaborative bodies have a great responsibility to channel your opinions now the EU has taken a number of positions and at least started the process. The political will exists. The fundamental work has begun and it's a matter of seizing the opportunity. If the snowball starts to roll, something very positive can result.

AN: Yes, I think we have an important mission, both from the political dimension and from the organisations representing the corporate sector, to try to exert influence in time. We are a small part of the EU and have a unique form of governance that we can be proud of. The Swedish Companies Act has an enormous advantage in the area of corporate governance, as it makes it so clear that it is the shareholders that decide through the forum of shareholders' meetings. In the Anglo-Saxon and continental traditions, the situation is quite different. For instance, in our system, it is the shareholders' meeting rather than the board of directors that appoints the auditors. That is a major issue and a typical example of how the body of corporate legislation penetrates the depths of Swedish business. I know that you wrestle with this kind of issue, and if we can help, through self-regulation, the Corporate Governance Board or other ways, we are happy and willing to do so.

How can the corporate sector support the work of the government, e.g. in the context of the EU?

BA: One way is to give us opinions and reactions in plenty of time when we receive new proposals such as green papers and the like. In the EU, it is often the case that things start to happen long before the media takes notice. The faster opinions are voiced and suggestions are submitted, the greater the possibility to influence us in the government. The corporate sector also has its own networks and contacts, but I still think it is god that we can sometimes be in contact with each other, because a coordinated approach has a greater impact than both sides acting individually. I also think that the business community ought to be more involved in the general debate on these issues. It is not certain that tougher measures from the EU against companies would be unpopular. I think there are quite simply too few business leaders and owners making their voices heard at a same time when it is vital that the business community takes an active part in the debate.

Why is it important for the business community to get involved in these issues at an early stage?

AN: Let me give an example concerning self-regulation. The new International Financial Reporting Standards, IFRS, are an example of self-regulation. The EU has stated that it will apply IFRS, but it is a self-regulation body that writes the rules. The rules that affect us next year began to take shape in 2001 and 2002, so there is a lead-time of around eight years from idea to implementation. This applies to EU work in general, and it is therefore vital that we act there and at home. And I agree that we must also try to create an understanding of these issues among the general Swedish public.

BA: This long term perspective, that things take such a long time, is problematic for a number of reasons. For one thing, it is difficult to sustain debate on an issue among the general public for such a long period, and for another, when I look around the table at the Ministerial Council, I see new faces all the time. This means that we have to learn and practice perseverance in international work. It is essential to work systematically and to have a good memory if we are to make progress. I think perseverance and a good memory are key success factors in good negotiations.

And what bearing does that situation have on the issue of self-regulation?

AN: We run into problems, for example, when faced with things like the directive requirement concerning audit committees. We also have the whole issue, which is a global one, of what is meant by good internal controls. So it is important that we try to find ways to cooperate and ways to tie this all together in a way that works from the perspective of the government, as you are the ones that must manage our membership of the Union. The next step is then to find possible models to make it work in a self-regulating environment.

BA: Yes, there is currently a Government Committee examining the issue of audit committees which has concluded that we can probably avoid the need for legislation, but it is not entirely certain. We try not to invent new regulations as result of EU directives if there is an alternative. Sometimes we can find these alternatives, at other times it is more difficult.

But if the Code is now extended to cover all listed companies, does that make it easier?

BA: Yes, it should. We are looking for solutions, but this is where we are right now.

AN: I think it's very good that the Corporate Governance Board has taken the initiative to spread the Swedish corporate governance model internationally. As the capital markets become more global, advisory bodies like RiskMetrics, (formerly ISS), are becoming more important, and they have many preconceived ideas.

BA: I agree entirely. There are opportunities to work efficiently and effectively when we have other rules. We can get more people to understand our point. It is not always the case that people in other EU member states agree with us or think our way is better, but we will reach better decisions and agreements if they at least understand and respect what we do. That provides the conditions to create a regulatory framework in which our approach can also be included. The missionary work of the Corporate Governance Board is also good because we want international actors to be interested in Swedish business and industry.

Do we utilise the Nordic dimension sufficiently in this context?

BA: To be honest, I can't really assess how similar we are in these areas. But I don't think we exploit the Nordic dimension enough in general.

We always need to seek alliances if we are to be effective in the European system. It is usually quite easy to enlist the support of the Nordic countries. But as we are small actors, we can be a little outspoken too. Of course we have better relationships with some countries than with others, but sometimes we have to be a little cheeky. For example, we should give more thought to the newer member states, as they are still in a construction phase. Their systems are less rigid and they are looking for the right ways forward, so, if we do a good job, we might be able to sell them some of our ideas.

AN: Exactly. In other contexts, the phrase "Financial Centre Stockholm" comes up quite often, and I believe that Stockholm genuinely has an opportunity to become an exciting financial centre. It is well positioned in the middle of the Baltic Sea region and it has a highly advanced market. It would therefore be good if self-regulation could the guiding star for such a development.

When EU regulations have been passed, the next stage is to implement them. Sweden is often described as over-ambitious in this respect. Are we?

BA: Yes, we want o do our homework, and I think that is actually the right attitude. Basically, if a decision has been made, we should also ensure that it is executed.

At the same time, not everything is black or white. This government has actually appointed a number of committees to investigate to what degree Sweden has over-implemented, i.e. not just done the minimum required by a directive but also, while we were at it, taken the opportunity to do more. This includes the directives on limited companies and the accounting and audit directives.

A current example that is often brought up is how Finland has handled the issue of audit committees and made a more liberal interpretation. How do you see the possibility of implementing the spirit of EU regulations rather than their letter?

BA: Generally, when it comes to companies and business operations, the ambition is to remove differences that provide obstacles to an open market. So it is not about having as few rules as possible, but that those that exist should be clear. The problem here is that we have a different legal background. The audit committee rule aims to create an independent audit, something that we have had in Sweden since the 19th century.

AN: I think that in general the Swedish legislative system, represented by the Ministry of Justice, has tried hard to find ways around such things. Take the existence of the Swedish Securities Council, for example. No one in the EU could imagine that such a council existed. Even so, the actors in the market seem to think it works very well, a view which is supported by the annual evaluation conducted by Finansinspektionen, the Swedish Financial Supervisory Authority.

It is clear that self-regulation is not a generally accepted model in the EU system, where the primary instrument is legislation. Do you see any possibility to initiate a discussion in Brussels about whether self-regulation could be a good way to implement European law?

BA: There are certainly possibilities to share our experiences and also to show that there is much that is good in Swedish enterprise, for instance our decentralised approach to how we work. Something that has surprised me, and that I enjoy in my work with the EU, is that there is much more discussion of ideas than people perhaps think, at least among ministers. We speak quite freely and more or less brainstorm at times. That kind of think is also important, because that's how you begin to understand how other people think. If we just sit with our paperwork and negotiate, it is easy to get bogged down. At such times, it is good to put the papers to one side. That way, we can often iron out problems and take a further step forward.

AN: We can take this argument further and say that the efforts of the EU in this area aim ultimately to create a freer and more open capital market that is more efficient, reduces costs and thus provides conditions for growth. They have believed that the best way to do this is through legislation. But we have a good example where it was found that legislation becomes too complex, and that is the review of takeover regulations, where an EU study claimed that the Swedish system of A and B shares is not to the advantage of a free capital market. It then turned out that the whole issue was much more complicated – there is not just the Swedish model, but also many others – so the Union decided to allow the market to handle the issue. So there are signs that what you say is starting to permeate Brussels.

BA: The Swedish presidency of the EU in autumn 2009 may be an ideal opportunity for the business community to push these issues. Seize the opportunity and exploit the increased interest that Europe will have in Sweden at that time. For the government's part, I can assure you that we are going to do a very good job. We will approach the presidency with pride, and we will be proud of what we have achieved when our six-month period is over.

If you have any questions or comments for the Swedish Corporate Governance Board, please feel free to contact us.

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