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European Commission Green Paper (com 2011 164), The EU corporate governance framework

The Third Swedish National Pension Fund (AP3) is one of five so-called buffer funds in the Swedish National Pension System. We are mandated by Parliament to generate maximum possible benefit for the pension system by managing our fund capital so as to deliver strong investment returns at a low level of risk. AP3 is an investor with a long term perspective, and manages a diversified global portfolio of listed equities, fixed income assets and alternative investments. Alternative investments consist of private equity, real estate, timberland, infrastructure assets and new strategies. The value of AP3's portfolio stood at SEK 220.8 billion on 31 December 2010.

AP3 notes that the discussion around the governance of financial firms, including the European Commission Green Paper (COM 2010 284) on Corporate Governance in financial institutions, have spilled-over on the questions asked in relation to a general regulation of listed companies. It is our opinion that it would be a mistake to transpose the failures in the financial sector during the recent crisis to corporate governance of corporations generally. Due to inherent differences in the member states with respect to legislation, self-regulation and ownership structures it's difficult to establish a set of rules for corporate governance in general or even only for shareholder engagement that would apply across Europe. Developing and sharing best practices drawn from the most successful experiences may, however, prove very useful. It is worth noting that the Swedish corporate governance model has received increasing international attention over the past few years. Recently, the World Economic Forum in its Global Competitiveness Report ranked Sweden as number one and two in a number of key corporate governance aspects. Sweden was ranked number two overall with its corporate governance model as a significant contributor. The Swedish model has developed over the years. It is, however, deeply rooted in a clearly defined and well-balanced distribution of power and responsibilities between the shareholders, the board of directors and the CEO.

AP3 also want to establish that the Swedish institutional owners have very clearly expressed their willingness to accept their share of ownership responsibility. It takes place in nomination committees, at meetings and in ongoing dialogues with companies. Since the Swedish Corporate Governance Code was introduced on the Stockholm Stock Exchange in 2005, the process has become smoother and more and more entrenched in businesses. That means we do not see any need for further regulation of corporate governance in Sweden. After this basic finding, we still want to respond to the questions in the Green Paper.

The first two questions deals with what types of companies that should be subject to regulation:

(1)	Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below?
(2)	Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

No. The choice of target group in the Swedish Corporate Governance Code (the Code) can be a good starting point for these issues. The target group for the Code is Swedish companies whose shares are listed on a regulated market in Sweden, NASDAQ OMX Stockholm and NGM Equity. Unlisted companies are not covered by the Code. While public companies can be very different in size and complexity, ranging from large, globally active companies to small domestic entrepreneur-run companies, the Code should be applicable to the full spectrum of these companies. This places great demands on the Code to allow flexibility when applying individual rules in practice, but also on companies when to choose solutions other than those specified in the Code and to explain these deviations when they feel they are justified.

1. BOARD OF DIRECTORS

In this section, we would like to highlight the Swedish system of nomination committees appointed by and largely manned by the owners, which in an international perspective is a unique solution. The sole task of the nomination committee is to propose decisions to the shareholders' meeting on electoral and remunerations issues and, where applicable, procedural issues for the appointment of the following year's nomination committee. Regardless of how they are appointed, members of the nomination committee are to promote the interests of all shareholders. In most other countries the nominating committee is a committee of the board, which makes it almost impossible to conduct an independent evaluation of the board because this means that they will evaluate themselves and their own work. Moreover, it is very difficult for members of the board to question their own role and it becomes harder to nominate suitable candidates for the new board.

(3)	Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

Yes. Swedish corporate law prohibits the CEO of a listed company from serving as its chairman at the same time. The board has a monitoring role in relation to management. In addition to dealing with major strategic issues, the board's main duty is to hire and, if necessary, fire the executive director of the company. Thus, it is obviously highly inappropriate that these are the same person.

1.1 Board composition

Competence and integrity are important characteristics of a director. Effective board work requires diversity in the composition that gives a width of the board's collective experience and knowledge. The composition of the board should be the responsibility of the owners, and owners should try to find suitable people outside the established networks to accommodate the boards. Therefore AP3 recommend a comprehensive inventory of potential candidates.

(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

No. There may be a need for a recruitment policy to identify the specific knowledge and experience that must be added to the board. However, it should be noted that in the Swedish system of nomination committees, it is not unusual that the nomination process starts by putting together a requirement profile for directors. This means that the Swedish system is able to handle requirement profiles in a good way.

(5) Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

No. Successful and efficient work by the board requires diversity in the composition that gives a width of the board's collective experience and knowledge. It is particularly important that companies with an international perspective have directors who can bring experience from different markets. The question of the board composition can be usefully addressed through a nomination system similar to the Swedish.

(6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

No. Although institutional investors typically do not have gender diversity as a direct profile issue, it is important that the proportion of women on boards continues to increase. The pace of change will obviously depend on what the development looks like in the rest of society and we need more women in senior positions in companies to broaden the recruitment base for boards. Responsibility for this rests mainly on the companies and their owners, and the issue of women on boards can be usefully addressed through a nomination system similar to the Swedish. Due to market economic reasons we do not think that quota rules are a good solution. The owners of companies, which bears the risk, must be allowed to choose whom they want to govern their companies. However, it is obvious that threats of introduction of quota rules create a pressure for change, which is good.

1.2 Availabilty and time commitment

(7) Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

No. That members of the board have more assignments than is optimal is true in some cases. However, a nomination committee should be able to deal with this problem. As the nomination committee shall consider all shareholders' interests, there is reason to believe that they will nominate candidates who are able to devote enough time for the mission.

One way to structure the work of the board, and at the same time clarify the bigger and more time-consuming work efforts, is to introduce different types of board committees. Committees of various kinds is both desirable and in many cases necessary for the board to function effectively. For example, a financial company with a board without a risk committee is probably an odd phenomenon after the financial crisis that we have recently gone through. However, it is important that the committees do not make any decisions and only prepares for decision-making since the board is collectively responsible for all decisions.

1.3 Board evaluation

(8)	Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

Yes. A structured evaluation of the board constitutes a basis for decision for the nomination committee. To ensure independence, it is often desirable that the evaluation is made by an external partner.

1.4 Directors' remuneration

Directors' fees shall be market based and proportionate to the responsibilities and workload. To ensure credibility in the boards' supervisory role in relation to executive management, the board and the management should not be subject to the same type of compensation system, such as share-based incentive programs. However, it benefits the owners that the board has incentives to manage the company in accordance with owners' interests. Therefore it is desirable that directors own shares in the company.

(9)	Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Yes. Remuneration of the board, as well as compensation for senior executives, should be clearly described in the company's remuneration policy to be determined by the shareholders at the AGM. It is essential that all parts of the total compensation package is described, cash compensation, any share-based payments, pension plans as well as other economic benefits.

(10)	Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

Yes. The remuneration policy should be determined by the shareholders at the AGM.

1.5 Risk management

(11)	Do you agree that the board should approve and take responsibility for the company's "risk appetite" and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?
(12)	Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

Fundamental company law principles already place a responsibility on the board to ensure that the company is managed in the best interest of the shareholders. This includes a responsibility for the risk profile of the company. AP3 do not see a need for further regulation in this regard. The proposals in this part seem to spill-over from the policy thinking regarding financial institutions that are in a specific risk-taking business, and are not well-placed in a debate regarding corporate governance for the broad community of companies.

2. SHAREHOLDERS

2.1 Lack of appropriate shareholder engagement

2.2 Short-termism of capital markets

(13)	Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behavior.

AP3 refrains from responding.

2.3 The agency relationship between institutional investors and asset managers

(14)	Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?
(15)	Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

14. No. AP3 believes in transparency and disclosure also for asset managers and asset owners regardless of investment horizon. We believe this is best done by self-regulated codes and industry initiatives in order to promote best practice and not by detailed regulation at EU-level.

15. No. Transparency and disclosure is ultimately an issue between the asset owners and asset managers in particular when the asset owners are institutional owners. It is in the interest of the institutional investor to monitor asset managers with regard to strategies, costs and trading. For those institutional investor or asset managers that find that it is beneficial to engage with companies it is also in the interest of the institutional investor to monitor the engagement. There is no need to regulate or promote more effective monitoring.

2.4 Other possible obstacles to engagement by institutional investors

(16)	Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?
(17)	What would be the best way for the EU to facilitate shareholder cooperation?

16. No. AP3 is in favor of transparency on these issues. In Sweden we already have had these requirements in the Swedish Code of Conduct for fund management companies by the Swedish Investment Fund Association. The EU regulation under the UCITS framework is another example. In addition there are several self -regulation codes based on the "comply or explain" regime recently introduced or revised such as UK Stewardship code and EFAMA (European Fund and Asset Management Association) Code for External Governance covering these issues as well as requirements from asset owners. Hence, AP3 does not see additional regulation at the EU-level as necessary.

17. Cross-border voting is still problematic and the full impact of the Shareholders' Rights Directive (2007/36/EC) for the individual investor has not yet been seen. We are surprised over the

difficulties issuers in many member states still seem to have to find out who are their owners. We receive a number of requests from firms representing issuers asking for information about our equity holdings. In this area we see room for improvement regarding transparency of the ownership in many member states.

2.5 Proxy advisors

(18)	Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?
(19)	Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

No. AP3 believes transparency, regarding especially conflicts of interest, is of great importance for this industry due to the great influence it has reached as cross border voting and engagement has increased. We have often been surprised that the possibility to influence the voting in order to fulfill the ownership policy of the owners is so limited for some proxy advisors. We believe, however, that this should be facilitated by self-regulated codes and industry initiatives in order to promote best practice and not by detailed regulation at EU-level.

2.6 Shareholder identification

(20)	Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

Yes. This is not a problem in Sweden where the issuers already have both the legal and technical mechanisms to identify their domestic and foreign shareholders (provided that the foreign shareholders have chosen to be identified). However, we do see room for improvement regarding the transparency of the ownership in many other member states. It is also important that the information is made public in order to facilitate cooperation between shareholders. Making the information available only to companies will not increase the possibilities for owners to cooperate and thereby increasing the problems with management entrenchment.

2.7 Minority shareholder protection

(21)	Do you think that minority shareholders need additional rights to represent their interest effectively in companies with controlling or dominant shareholders?
(22)	Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

No. AP3 believes it is of great importance to protect minority shareholders rights and in the case this is not fully provided for in other member states changes should be considered at a national level. There are already rules on minority protection in the Swedish company law and further rules are not needed. Furthermore, the Swedish Corporate Governance Code states that a majority of board members should be independent in relations to larger owners, the management and the company itself.

2.8 Employee share ownership

(23)	Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

No. The ownership structure of companies should not be regulated. For listed companies there are already, by nature, requirements on share distribution and number of shareholders.

3. THE "COMPLY OR EXPLAIN" FRAMEWORK – MONITORING AND IMPLEMENTING CORPORATE GOVERNANCE CODES

(24)	Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?
(25)	Do you agree that monitoring bodies should be authorized to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

Yes. AP3 supports the Commission´s views on the application of the "comply or explain" framework. Companies that choose to depart from the recommendations of the code should, in the same way as required by the Swedish Corporate Governance Code, provide explanations for such departures, and also describe which model they have chosen instead.

The Swedish Corporate Governance Board conducts an annual review of all corporate reports and publishes the result in their annual report. If corporate reports contain insufficient explanations for the discrepancies, or if they are entirely absent, the matter may also be addressed by the disciplinary committee of the regulated market. We believe that this may serve as a good example for other member states.

We hope you find these comments helpful.

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Third Swedish National Pension Fund

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