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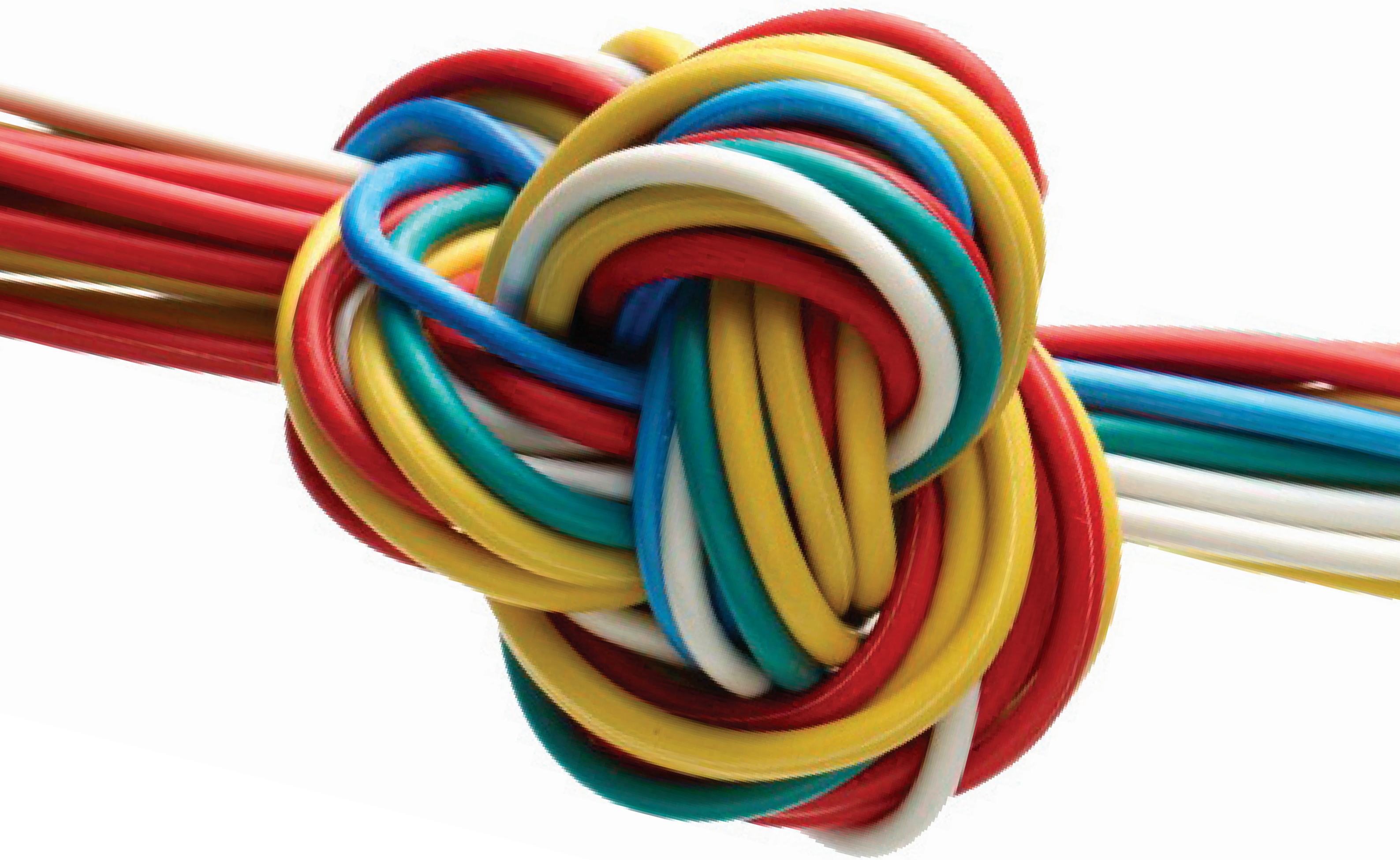

EU Corporate Governance Report

April 2011

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Foreword

Six years ago, Allen & Overy published a corporate governance report which, in the wake of Sarbanes-Oxley reforms in the United States, revealed that many senior European executives were still fearful of an Enron-type corporate meltdown. Many of our respondents told us then that the raft of corporate governance reform that followed the failures of Enron, WorldCom and Arthur Andersen had done little to improve the way businesses were run.

With so much change having occurred in the interim, we decided this year to conduct another survey, this time asking 100 senior executives from European companies for their views on corporate governance and its effectiveness across the continent. The global financial crisis has once again put boardroom behaviour under the spotlight, as well as ethical business practices and sustainability.

While governance reforms previously focused on companies, attention has now also shifted to shareholders who, like many others, are perceived to have taken their eye off the ball during the financial crisis. Last year the UK took the lead in the EU when it published the Stewardship Code, aimed at enhancing relations between institutional investors and corporates so as to improve long-term returns and the way governance responsibilities are carried out.

The European Commission has stated its intention to examine governance in European corporates through the publication (in April) of its own Green Paper looking at, among other things, issues around shareholder engagement, board composition and enforcement of corporate governance guidelines.

The consensus that emerges in the pages that follow is that European company executives are highly sceptical of a one size fits all approach to governance. Corporate governance is the product of local regulation and culture. The considerable differences that exist between the national models of corporate governance lead executives based in different countries to reach differing conclusions as to the way many governance issues should be addressed compared to their counterparts in other countries, making EU-wide measures a challenge.

The European Commission must balance the need for growth with the need to manage risk. The challenge is therefore to weigh up whether any new proposals will make a positive difference to the way businesses are run, or merely add to the burden of red tape which is already costing some of our respondents more than EUR2 million a year.

49%

believe the EU Commission should not introduce pan-European guidelines on governance

82%

are against compulsory quotas for women on boards

Executive summary

A number of key themes emerge in this report, which the European Commission will need to be mindful of as it seeks to adopt measures to enhance corporate governance across Europe. In particular:

- Almost half of European corporate executives are against the introduction of pan-European corporate governance rules. There is a stark difference of view on this issue between UK-based executives and their continental counterparts.
- 82% of respondents are against the introduction of compulsory quotas for women on boards.
- 78% believe corporate governance guidelines should only be enforced on a comply or explain basis, with just 12% wanting to see sanctions, whether civil or criminal, introduced.
- 57% believe investors are more engaged than ever before. Private meetings or presentations are the most common form of engagement.
- 78% of executives believe institutional investors should adhere to a code of conduct and 57% believe the code should be international. 73% agree that voluntary codes have a role to play in improving standards of engagement.
- 77% of executives believe linking variable remuneration to performance improves company performance.
- Only 11% believe that their anti-bribery policies have caused them to turn away business in the past 12 months, but 23% expect that compliance with the Foreign Corrupt Practices Act 1977, the UK Bribery Act 2010 or equivalent legislation will cause them to turn away business in the future.

78%

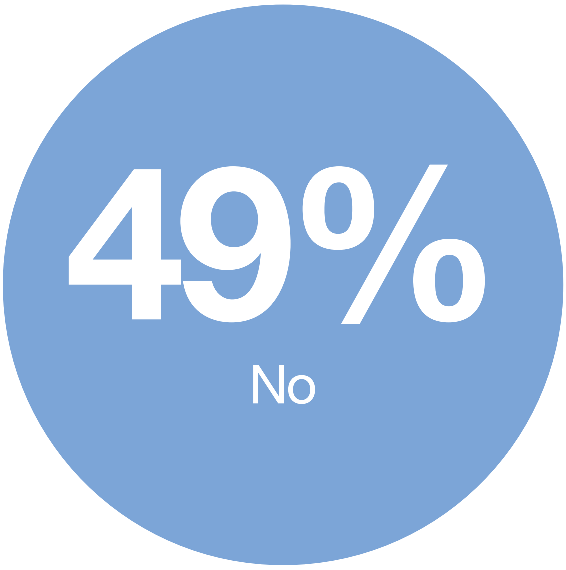
believe that comply or explain is the best method for corporate governance enforcement

57%

believe shareholders are more engaged than ever before

EU corporate governance guidelines

Should the EU Commission introduce pan-European guidelines on governance in corporates?

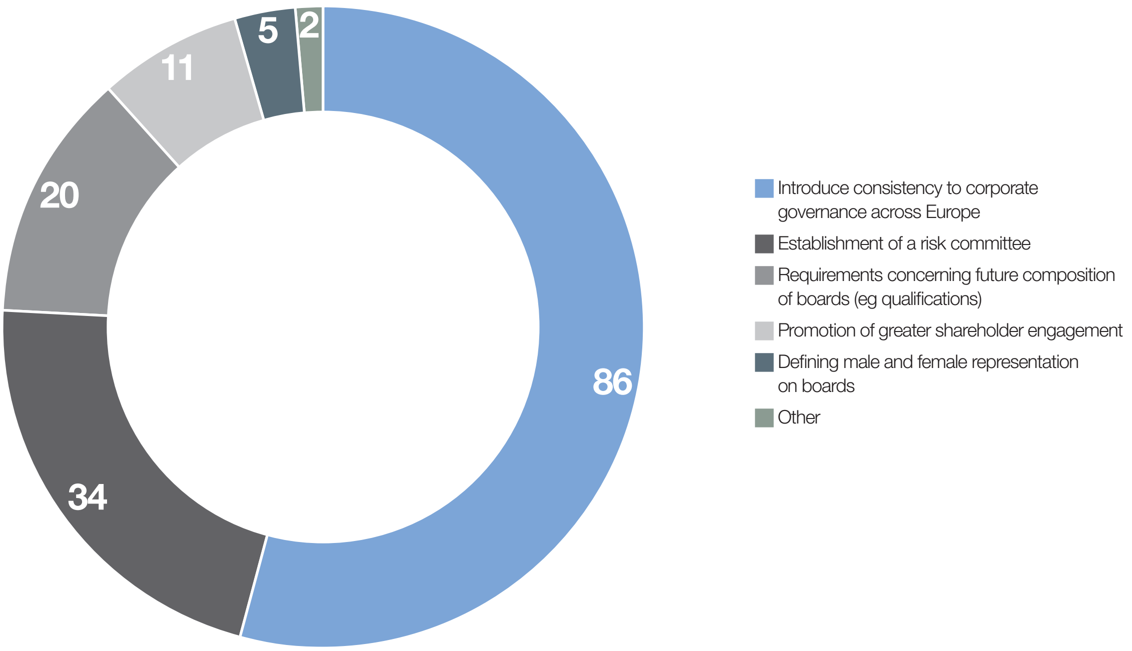


UK

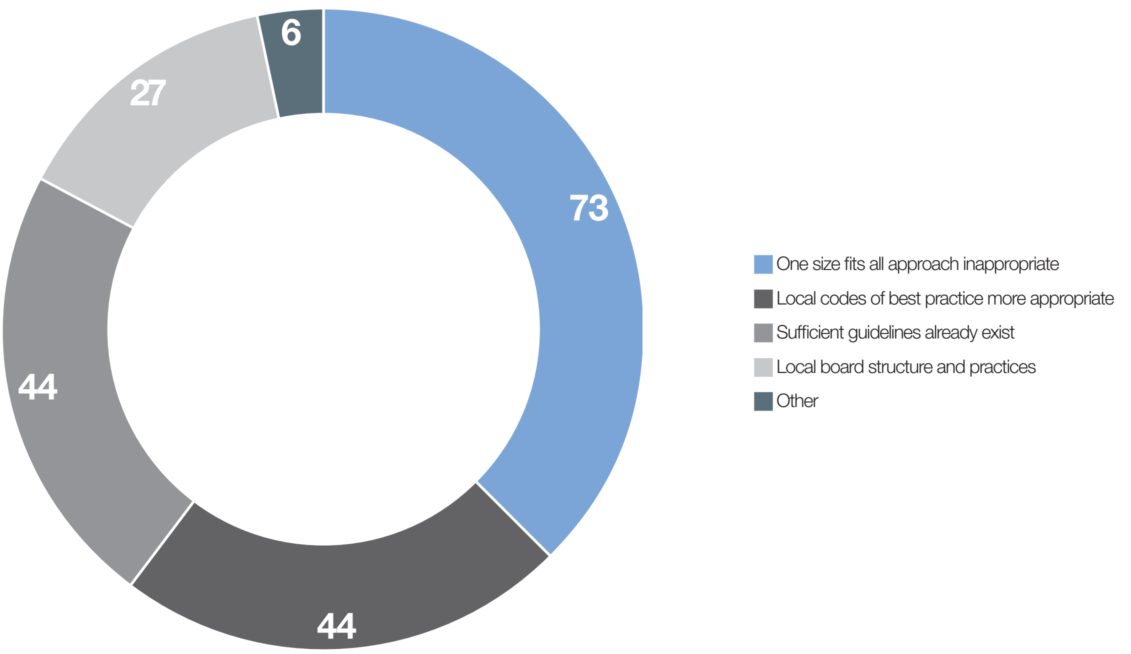
Continental Europe

[All figures shown represent a percentage]

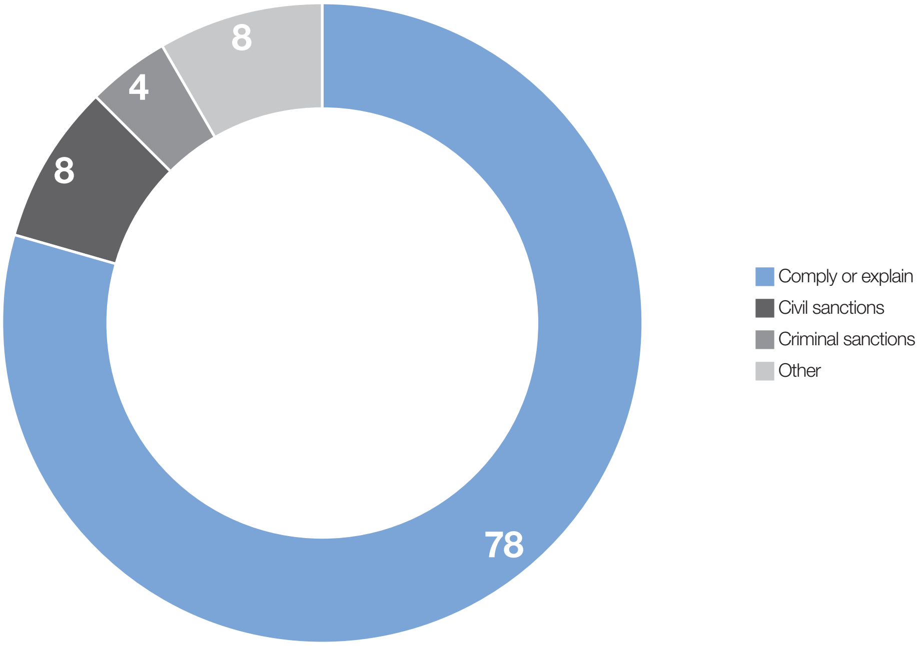
If yes, which of the following would be most important to you?



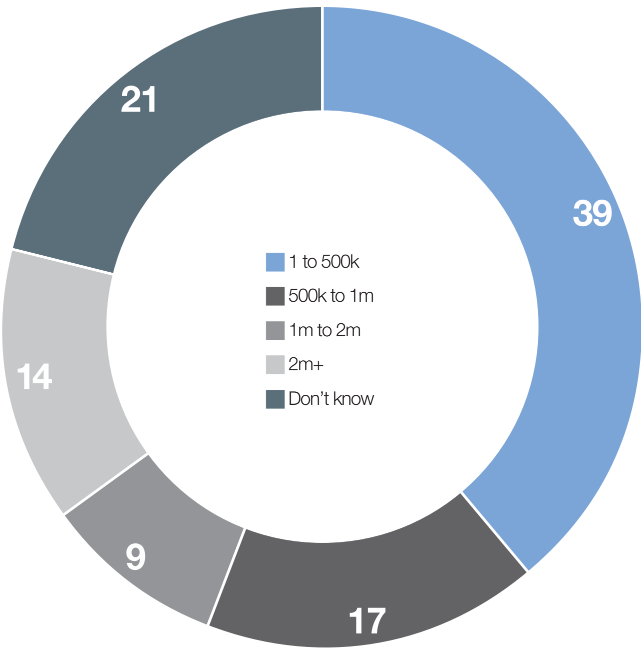
If no, why?



How should guidelines on governance be enforced?



Please estimate how much your company spends on compliance with governance guidelines (EUROS)



23%

of European companies spend over EUR1 million on corporate governance compliance

[All figures shown represent a percentage]

Board composition

After the financial crisis there were calls for greater diversity at board level. EU Justice Commissioner Viviane Reding has called on listed companies to sign a pledge to increase the presence of women on corporate boards to 30% by 2015 and 40% by 2020, by actively recruiting qualified women to replace outgoing male board members. The European Commission wants to publicise which companies sign up to the pledge, and if that does not work there is the threat of the imposition of compulsory quotas.

Norway introduced a quota of 40% in 2008. France's corporate governance code for listed companies was amended in April 2010 to include targets for the number of women on supervisory boards. The French code recommends achieving 20% representation within three years and 40% within six. In Germany, there is no law dealing with the representation of women so far and only the non-legally binding German Corporate Governance Code addresses the gender imbalance.

However, the German government is monitoring developments closely and is believed to be prepared to pass a strict law if the number of women on German boards does not increase.

Should there be compulsory quotas introduced for the number of women on boards?

82%

No

59%

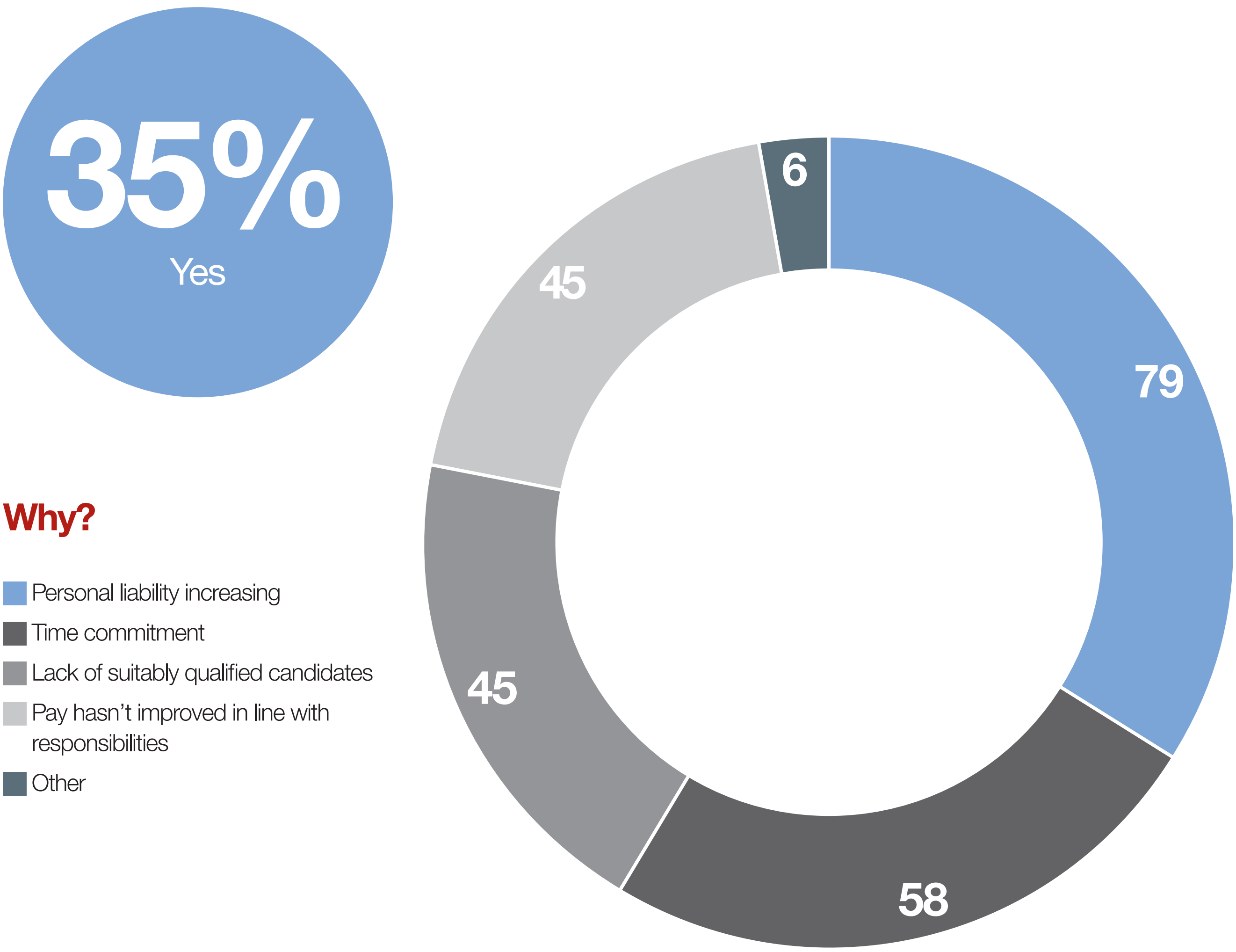
think the increased regulation in corporate governance over the last ten years has led to improvements in the way businesses are run

It therefore looks likely that European businesses will be pushed to start complying with board level quotas voluntarily. Among our respondents, only 8% were in favour of mandatory quotas, with opposition particularly high in the UK, where 95% are opposed. Generally, we find clients supportive of diversity in the boardroom but reluctant to see gender singled out for legislation.

Perhaps surprisingly, the executives we surveyed are split over whether further reforms of EU and other governance rules will make recruitment to non-executive board positions harder, with 35% saying they will and 36% disagreeing. Those that feel non-executive directors will be put off joining boards blame the increasing personal liability, the time commitment required, and a lack of suitable candidates. The risks facing directors are certainly perceived to have increased, with the volume of new legislation and the regulatory focus a primary concern for executives. We see a trend towards directors and officers seeking out training and education for their increasingly demanding roles.

Legislation in France and Germany provides that the same individual cannot hold more than a particular number of directorships in different companies. It is worth mentioning that more than half of the executives we contacted support limiting the number of boards on which a director can sit.

Do you feel reforms of EU and other corporate governance rules will make recruitment of NEDs significantly harder?



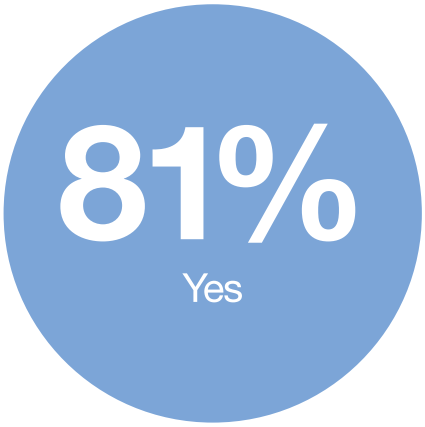
Support for the proposal is particularly high among non-financial services companies, and in listed companies outside the UK. Forcing directors to sit on fewer boards would in theory mean they had more time for full and proper fulfilment of each role, but would also serve to limit further the already challenging pool of available candidates. In some smaller EU countries, such legislation might be particularly detrimental to recruitment options.

51%

of executives believe the number of boards on which a director may sit should be limited

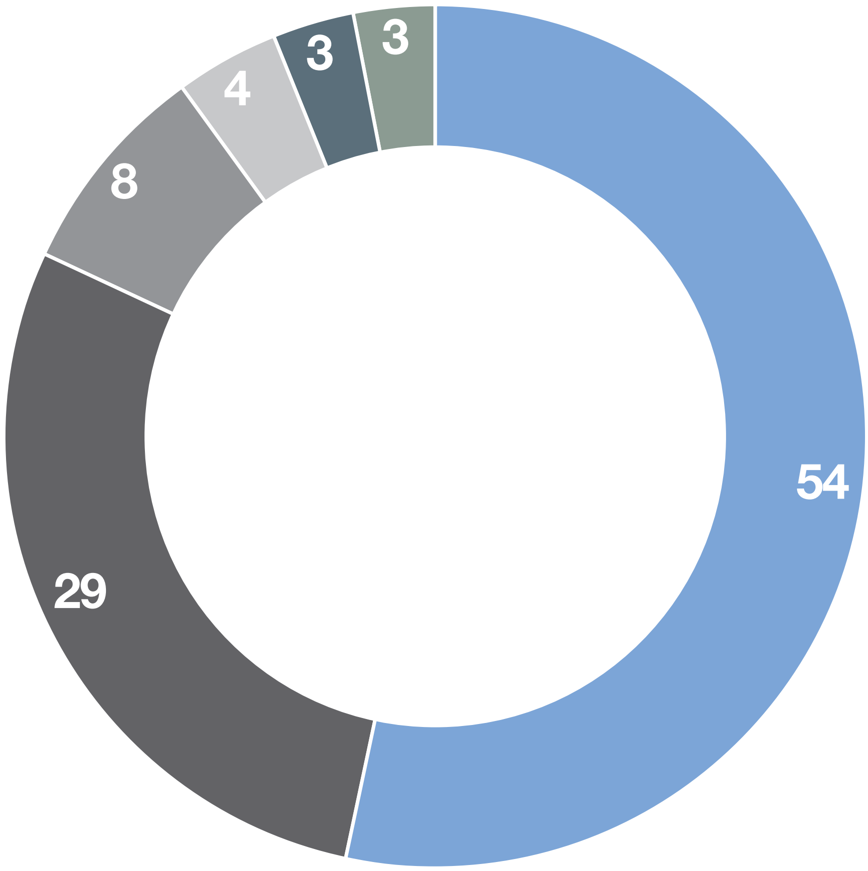
Do you think there is a shortage of qualified directors for today's companies?

Have the risks facing directors increased?



When thinking about increased risk, which of the following is your top concern?

- Volume of new laws regulations
- Regulatory attitude and focus
- Anti-fraud and corruption legislation
- Greater shareholder activism
- Greater scrutiny by the media
- Not stated



[All figures shown represent a percentage]

Remuneration

Another issue expected to be examined by the European Commission is executive compensation, which has been a major topic in the aftermath of the financial crisis. Almost three out of four executives (73%) say that worker representatives should not have a role in setting board remuneration, as has been proposed in some quarters and already takes place in certain European jurisdictions. Perhaps unsurprisingly, just 10% of respondents support worker representatives having a say in setting pay.

The European Commission may get tougher on disclosing remuneration below board level, and could propose legislation. That agenda is consistent with what we are seeing in the financial services industry, where media attention has turned to the very highly-paid individuals employed below board level. Outside of that sector the issues are somewhat different, but concerns highlighted by the banking regulators are being replicated by shareholders of other companies. In the UK, there have been detailed disclosure rules about board directors for a number of years, but the number of people affected by that legislation can be quite small, with some companies only revealing the pay of their CEO and finance director.

Another important topic is the extent to which senior employees should have their pay packages linked to performance, and what those performance metrics should be. Three-quarters of our respondents are in favour of variable remuneration linked to performance, saying it serves to improve a company's results.

It will be interesting to see whether shareholders start putting more pressure on boards for a better alignment between the interests of shareholders and executives, and whether the Green Paper includes any steps designed to make that happen.

Do you believe worker representatives should have a role to play in setting board remuneration?

* Not relevant due to worker representatives on the board.

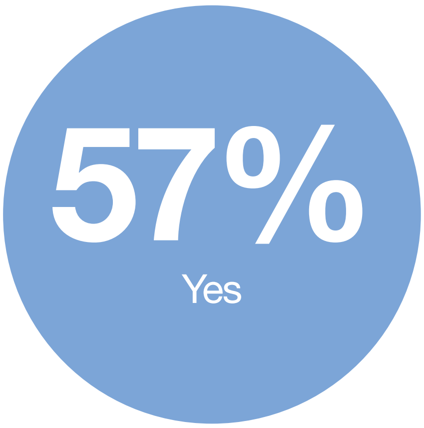
Does linking variable remuneration to performance improve company performance?

* Not relevant due to worker representatives on the board.

Shareholders

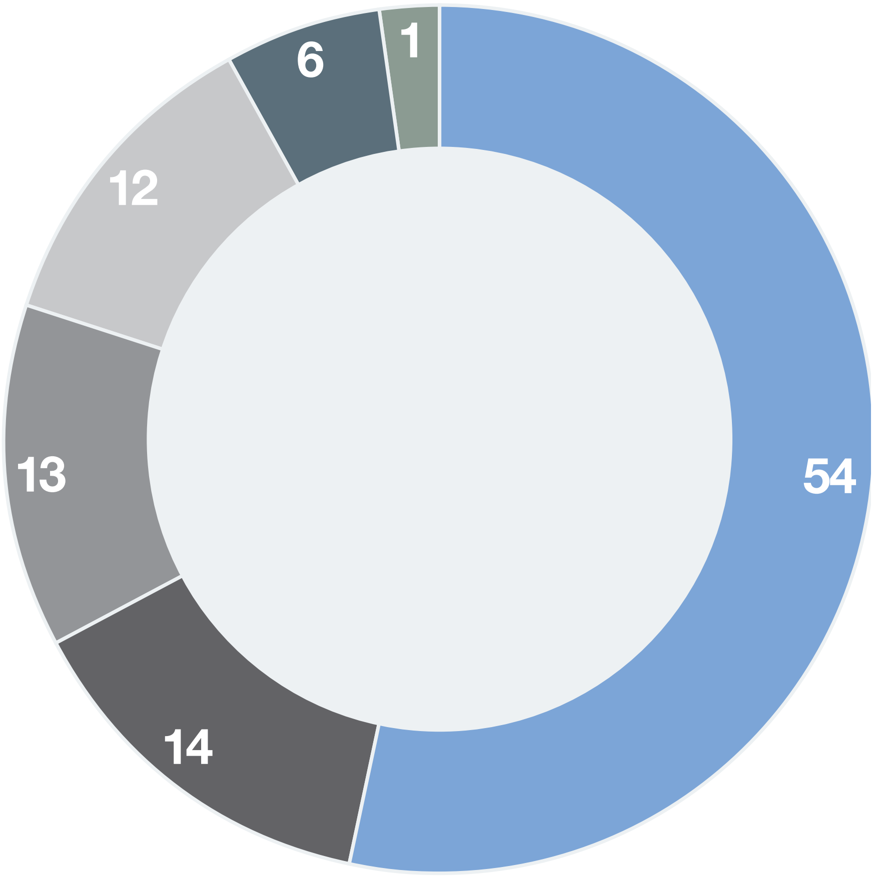
The majority of the executives we surveyed tell us that their shareholders are becoming more engaged, although one third have not witnessed any change. The findings appear to suggest that this is most evidenced on a one-to-one basis during private meetings or presentations.

Are shareholders becoming more engaged?



In what way, or ways, are shareholders becoming more active?

- Private meetings or presentations
- Publicly voicing opinions
- Attendance at AGM
- Telephone calls
- Other



[All figures shown represent a percentage]

While the jury is out on general pan-European guidelines, the findings suggest that the European Commission might have a role to play with shareholders and, in particular, codes of conduct. The research reveals strong calls for an international code of best practice for institutional shareholders. The UK has already led efforts in this regard, with the publication last year of the Stewardship Code on best practice for shareholders. Since its publication, more than 140 fund managers, asset managers and advisory firms have already signed up to the UK Stewardship Code.

Three-quarters of our respondents believe that these voluntary codes play a role in raising standards in shareholder engagement, and this support is even higher in the UK, where 88% back the effectiveness of such codes. It is here that we see the European Green Paper may have a role to play.

The executives we surveyed identify short-termism as the greatest barrier to shareholder engagement (51%), followed by shareholder apathy, which is blamed by four out of ten

Should institutional shareholders have to adhere to a code of best practice?

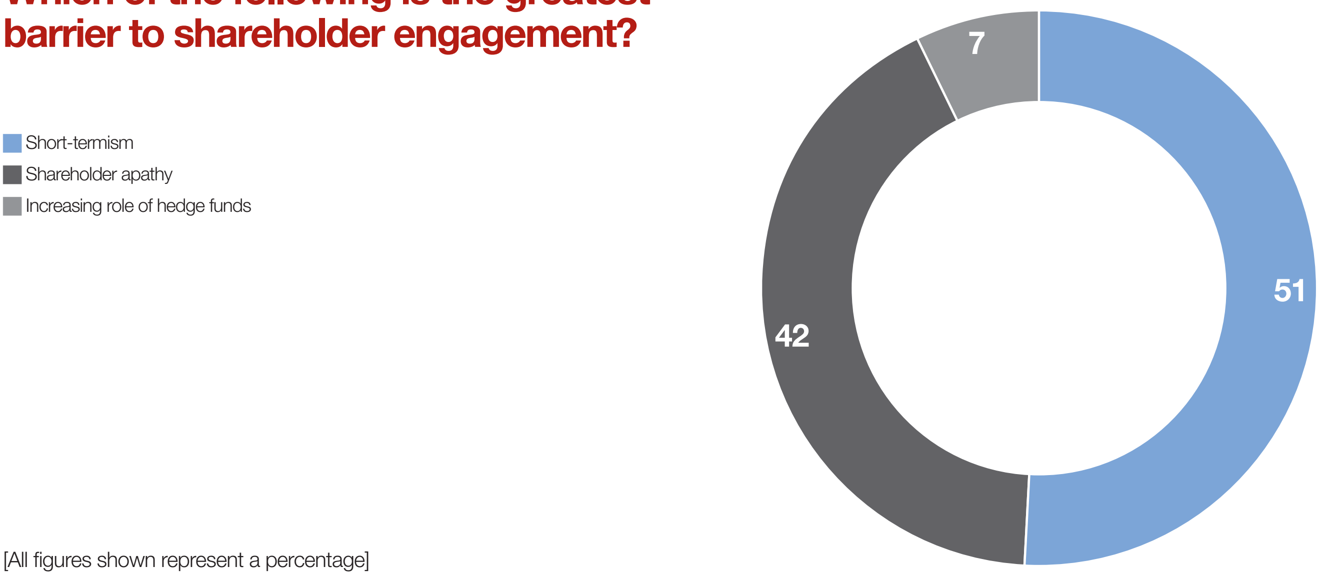
If yes, should a code of best practice be national or international?

respondents. The increasing role of hedge funds is identified as a barrier to engagement. An over-reliance on proxy advisors is seen as a problem by 44% of those we surveyed, and is a particular issue in the UK, where more than half (55%) view it is a concern.

We were not surprised to find that boards continue to see the greatest influence over them as being external institutional investors and government regulators, and less from hedge funds, proxy advisors and the media.

Do voluntary codes have a role in raising standards in shareholder engagement?

Which of the following is the greatest barrier to shareholder engagement?



[All figures shown represent a percentage]

Bribery and corruption

The UK Bribery Act, which will now come into force on 1 July 2011, creates two new general offences of bribery: a specific offence of bribery of a foreign official, and an offence of failure by a company to prevent a bribe being paid on its behalf. The offence of failing to prevent bribery can be committed by any company that carries out part of its business in the UK, thereby extending the jurisdiction of English law to many corporates that were formerly beyond the reach of English bribery law.

It is the new offence of failing to prevent a bribe being paid on the company's behalf that has been accused of lacking clarity, as it could potentially leave corporates vulnerable to the actions of their suppliers or joint venture partners whose activities they know little about. There is a statutory defence for companies that can show they had in place adequate procedures to prevent bribery taking place. Guidelines about those adequate procedures were published at the end of March.

European corporates need to be aware of the extra-territorial nature of the act when it becomes law. Already, a quarter of the executives in our survey say that they expect that compliance with the US Foreign Corrupt Practices Act, the UK's Bribery Act and other similar laws will cause them to turn away more business in the future. That figure rises to 31% in the UK. Just over one in ten respondents say that their anti-bribery compliance procedures have caused them to turn away significant business opportunities in the past.

We would expect most sophisticated large corporations to already have in place corporate policies to counter bribery and corruption, but because of the introduction of the new corporate offence referred to above there will be a need to be in a position to prove it had adequate procedures in place as its defence. That puts a considerable onus on good corporate governance and means businesses need to be clear about the policies and procedures they should have in place, and ensure they are meeting expectations.

11%

believe their anti-bribery policies have caused them to turn away business in the past 12 months

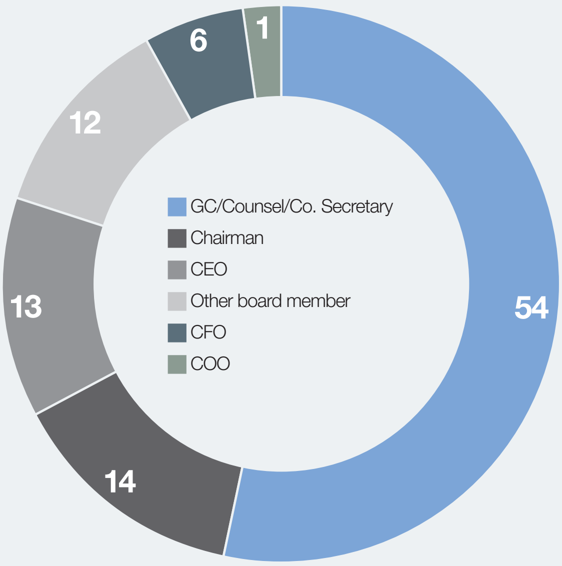
23%

think that compliance with the Foreign Corrupt Practices Act 1977, the UK Bribery Act or equivalent, will cause them to turn away business in the future

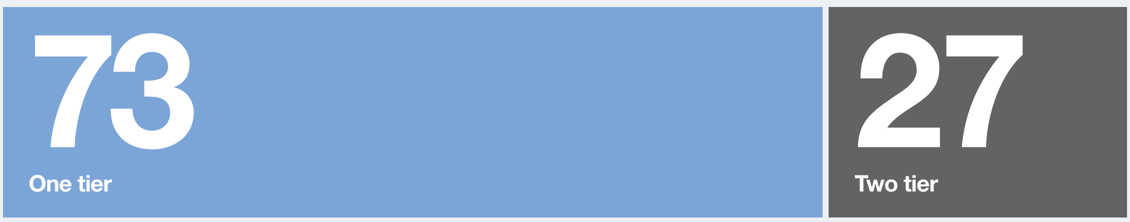
About the survey

Allen & Overy surveyed (online) over 100 senior European executives in March 2011.

What is your primary role in the organisation?



Which of the following best describes the board structure in your local jurisdiction?



Is your organisation a publicly-listed company or a private company?

[All figures shown represent a percentage]