



International Corporate Governance Network

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UNITED KINGDOM

Submitted electronically

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Subject: Eumedion's response to the review of the ICGN Global Governance Principles

Dear Mr. Payne,

Eumedion welcomes the opportunity to respond to a series of questions about the purpose, use, structure and content of the ICGN Global Governance Principles (GGP). By way of background, Eumedion is the Dutch based corporate governance and sustainability forum for institutional investors. Our 53 Dutch and non-Dutch participants represent more than € 5 trillion assets under management. Participants include a wide range of institutional investors; pension funds, mutual funds, asset managers and insurance companies. It is the objective of Eumedion to maintain and further develop good corporate governance and sustainability performance of Dutch listed companies. Below you will find our answers to the specific questions raised in the consultation document.

***Q 1: Are the GGP a useful resource for investors? How do they use the GGP at present?***

Yes. We agree with the remark in the preamble that the GGP are used by investors as benchmark in assessing investee company governance practices and in voting guidelines. Furthermore we believe that they serve as a global common practice which influences corporate governance regulatory developments and standard setting around the world.

**Q 2: Are there differences in how asset owners and asset managers make use of the GGP?**

We are not aware that there are differences in practice in the use of the GGP by asset owners and asset managers. We suspect that they both use the GGP as a source of global common practice.

**Q 3: Are the GGP a useful resource for companies? How do they use the GGP at present?**

This question falls outside the scope of the activities of Eumedion.

**Q 4: For what other interests and organizations could the GGP potentially be a useful resource, and why?**

This question falls outside the scope of the activities of Eumedion.

**Q 5: Is the current structure of the GGP clear and easy to use? Could it be improved?**

We are of the opinion that the current structure of the GGP is clear and easy to use.

**Q 6: Are there sections that should be added or taken away?**

We have a few suggestions for further improvement of the guidance. We elaborate on this below.

*Dialogue with the board should not be limited to governance matters alone*

We believe that investors should be willing to engage with investee companies. It follows from the guidance (1.2) that the board (particularly non-executive directors) should make available communication channels for meaningful dialogue on governance matters with stakeholders, like shareholders. Eumedion participants try to act as engaged and responsible share-owners, but cannot succeed without the cooperation of the investee companies. We believe that also the board should be willing to enter into a dialogue and that this dialogue should not be limited to governance matters alone and should also include aspects relating to e.g. environmental and social policy, strategy and risk management. We advise to reflect this position in the GGP.

*The majority of the members of the supervisory or one-tier board of a controlled company should be independent*

We believe that independent board members can contribute significantly to the decision-making of the board. The current guidance (2.5) states that a controlled company – where there is a dominant shareholder or block such that they ultimately have the majority power – should preferably have a majority of independent non-executive directors, or at least, three (or one-third) independent directors on the board. The preamble states that in controlled companies the governance considerations are primarily concerned with protecting the interests of minority shareholders. We are of the opinion that minority shareholders should be protected from abusive actions by controlling shareholders. However, we feel that guidance 2.5 fails to properly achieve this. We believe that in

listed companies with a controlling shareholder the majority of the members of the supervisory or one-tier board should be independent.<sup>1</sup> We suggest to reflect this position in the GGP by deleting the phrase “or at least, three (or one-third) independent directors”.

*Relationship agreements should be concluded with controlling shareholders*

As already mentioned above, we believe that minority shareholders should be protected from abusive actions by controlling shareholders. We opine that the guidance 8.3 fails to properly achieve this. The current guidance states that “The use of relationship agreements with controlling shareholders is encouraged to ensure that real or potential conflicts of interest are avoided or mitigated”. We believe that the company and the controlling shareholder should draw up a relationship agreement which at least confirms that all transactions between them will be agreed on customary market terms, regulates any representation on the board and contains assurances that all appearance of insider trading will be combatted.<sup>2</sup> We suggest to reflect this position in the GGP.

*Existing reporting frameworks should be used as a starting point*

We would like to make a general comment on Principle 7 Reporting & Audit and the accompanying guidance. The guidance feels rather incomplete. A lot of work has already been done by the IFRS Foundation on financial reporting through its standards and its conceptual framework; and by the International Integrated Reporting Council (IIRC) on the management report and by the Global Reporting Initiative on sustainability metrics. This paragraph would gain strength if it were to explicitly take certain frameworks as a starting point and focus on any additional guidance that deserves the attention of the board.

*The generic call for prudence for the annual report and accounts should be deleted*

Eumedion is against a generic call for ‘prudence’ for the annual report and accounts as mentioned in guidance 7.3 (d). A discussion on prudence resulted in heated debates in 2014 when the International Accounting Standards Board (IASB) was consulting its draft Conceptual Framework. The outcome is effectively that there may be a role for conservatism in situations of high uncertainty. Individual standards can have elements of conservatism, but within IFRS there is no generic call for conservatism in either standard setting or in the application of the standards. Generally, a neutral application of the standards is expected. Guidance 7.3 (d) can be read as a call on companies to apply standards in a conservative manner. This is at cross with IFRS and such call has the negative effect of trying to undermine the consistent application of IFRS around the globe. The second

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<sup>1</sup> This is also recommended in the position paper published by Eumedion on the position of minority shareholders in companies with a controlling shareholder (<https://en.eumedion.nl/clientdata/217/media/clientimages/2016-06-position-paper-minority-shareholders-final-version.pdf?v=200803135314>).

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negative effect is that in general, overly pessimistic reporting is no improvement over neutral reporting. A call to report more conservatively than neutral, immediately raises the question how conservative an individual company should apply existing standards. Subsequently, investors will need to guess for each company how conservative the board has been in its application of the standards. There is the paradox that a conservative recognition of revenues and profits in one period is likely to result in recognition of these revenues and profits in a subsequent period. Compared to neutral application, a conservative bias in accounting therefore results in delayed information to investors. Investors would tend to discover at a later stage that a company is doing well; and also at a later stage that the company is no longer doing so well. Eumedion therefore concludes that useful reporting is generally best served by standard-setters to set neutral standards, and by a requirement for preparers to apply these standards in a neutral manner.

#### *Technical remarks*

- The scope of guidance 5.2 is not clear to Eumedion. We believe that the comprehensive approach to the oversight of risk which should be adopted by the board should also include governance risks. Eumedion advises to clarify this in the GGP.
- Guidance 7.3 provides for some requirements with respect to the information provided in the annual report and accounts. We believe that those requirements for financial reporting are not comparable with the strength and thoroughness of the IFRS Conceptual Framework. Investors are better off if companies adhere to the IFRS Conceptual Framework than if companies adhere to this paragraph. Against this background we prefer a reference to the IFRS Conceptual Framework and advise to reflect this position in the guidance.
- Guidance 7.4 states that the board should confirm in the annual report that it has carried out a robust assessment of the state of affairs of the company and any material risks, including to its solvency and liquidity that would threaten its viability. Instead of focusing on the solvency of a company, we prefer a company to report on short term continuity (up until one year after publication of the annual report) and longer term viability. A company's continuity can be at risk even though it is quite solvent, and reversely, a company may have negative book equity (technically insolvent) and still have limited continuity risks. We advise to reflect this position in the guidance.
- According to guidance 7.4 (b) disclosure on risk should include a description of (among other things) risk to returns expected by shareholders with a focus on key consequences. We believe that companies cannot be expected to comment on expectations of shareholders. We advise to reflect this position in the guidance.
- The description of integrated reporting that is included in guidance 7.5 falls short of the well-recognised <IR> Framework as published by the IIRC. Against this background we prefer a reference to the <IR> Framework.

- Guidance 7.7 states that the board should publish the report from the external auditor which should provide an independent and objective opinion whether the accounts give a true and fair view of the financial position and performance of the company. We believe that this requirement is too basic and undercutting reality in many jurisdictions. Many auditors already provide long form audit reports. We advise to reflect this in the GGP.
- Guidance 7.10 states (among others) that the audit committee report should include a summary of its discussions with auditors, including how any major concerns were addressed, to enhance investor confidence in the audit process. We believe that reporting should provide transparency, even if it were to result in a reduction of investor confidence in the audit process. Therefore, we advise to delete the phrase “to enhance investor confidence in the audit process” from guidance 7.10.
- Eumedion supports that all significant related party transactions should be based on the approval of a majority of disinterested shareholders (guidance 8.5). Eumedion wonders what is covered by the term “significant RPTs above an appropriate materiality threshold”. We take the view that major transactions between the company and the controlling shareholder and the granting of additional rights, such as extra voting rights or a veto right, to the controlling shareholder should be covered by that and subject to ‘independent’ shareholder approval.<sup>3</sup> We advise to reflect this position in the guidance.

***Q 7: Is the level of detail in each section of the GGP sufficient? If not, which parts of the GGP could usefully be expanded? Are there elements that should be removed?***

We refer to our answer to the previous question.

***Q 8: Should distinctions be made in terms of company size or ownership structure?***

We are not in favour of making distinctions in terms of company size. The preamble states (among other things) that the GGP are focused around company governance and how board directors should promote successful companies. Corporate governance is a critical indicator in the investment decision-making process of many long-term institutional investors. Good corporate governance demands customisation; no ‘one size fits all’ approach is possible. The current GGP already provide for the opportunity to adapt the corporate governance of a company to the specific characteristics of the business and needs of that company. This is reflected in the preamble which states that “Members of the ICGN support the flexible application of GGP and the specific circumstances of individual companies”. We support the current approach of the GGP of high standards but flexible application and are not in favour of introducing lower governance standards for smaller listed companies.

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With respect to ownership structure we believe that distinctions should be made. As already mentioned above we believe that the interests of minority shareholders in companies with a controlling shareholder should be better protected. We refer to our previous suggestions in this respect.

***Q 9: Should other distinctions be made?***

No.

***Q 10: Is the structure and scope of the current the GGP appropriate or would it benefit from adding new topics or considerations?***

We believe that the GGP could benefit from adding new topics or considerations. We refer to our answer to Q11.

***Q 11: Do any of the possible new topics listed above make sense for inclusion or greater emphasis in the new GGP?***

Yes. We believe that it makes sense to include some of the listed topics (partly) like: a) purpose of the company: shareholder and stakeholder considerations, b) company boards and Sustainable Development Goals, c) non-financial reporting and key performance indicators and d) diversity (not only gender, also race). With respect to the latter, we agree that measures regarding diversity should not be limited to gender alone. A board with diversified membership can contribute to the functioning of those bodies, which is of huge importance for institutional investors. Guidance 3.1 already states that “The board should disclose the company’s policy on diversity (including gender, ethnicity, cognitive and social) in relation to its senior management and board (both executive and non-executive)” and that “Companies should report on current board diversity, measurable targets and progress made in achieving such targets”. We believe that companies should also report on the objectives of the diversity policy and how this policy has been implemented.<sup>4</sup>

***Q 12: Are there any other topics or factors not currently covered by the GGP which should be addressed?***

We have no suggestions in this respect.

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<sup>4</sup> This is also in line with the Dutch corporate governance code (best practice provision 2.1.6).



We hope that our comments and suggestions are of any assistance. If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Diana van Kleef ([diana.vankleef@eumedion.nl](mailto:diana.vankleef@eumedion.nl), tel. 070 2040 302).

Yours sincerely,

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