Corporate Governance Code Monitoring Committee

third report on compliance with the

Dutch corporate governance code

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Secretariat: P.O. Box 20201, NL 2500 EE The Hague

www.commissiecorporategovernance.nl

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Summary

Introduction

Well-managed companies are of crucial importance to the health and competitiveness of the economy. The Dutch corporate governance Code (referred to below as the code) contains principles and best practice provisions for good corporate governance. Compliance with the Code is mandatory by law for Dutch listed companies. Compliance is in accordance with the ‘apply or explain’ principle. In other words, provisions of the Code should be applied unconditionally or an explanation should be given for any departure from them. The management board and supervisory board of a company account to the shareholders for the corporate governance structure that has been adopted and for compliance with the Code.

The effectiveness and success of the Code depend on how it is used in practice. To ensure that the Code is up-to-date and practicable and to monitor its application and compliance the government established the Corporate Governance Code Monitoring Committee (referred to below as the Monitoring Committee) on 6 December 2004. It is up to the Monitoring Committee to provide general information about how the Code is complied with and applied in practice, partly in the light of international developments. In 2005 and 2006 the Monitoring Committee published its first and second report on compliance with the Code.

The following aspects are central to the third report:

a) compliance with the Code by Dutch listed companies, including the quality of the explanation given;

(b) activities of shareholders, including compliance by trust offices and institutional investors;

(c) international developments;

d) internal risk management and control systems;

e) remuneration of management board members;

f) diversity in the composition of supervisory boards.

The Monitoring Committee has commissioned surveys by various institutions and conducted interviews with the parties concerned in order to obtain information about the above issues.

I. Compliance with the Code by listed companies

Compliance with the Code appears to have stabilised to some extent. The rate of compliance with the Code by listed companies in 2006 was slightly lower than in 2005 (95 % compared with 96%). The rate of application fell from 92% to 90%. The Monitoring Committee believes that improvements would be desirable. The following specific points can be made.

As in its report on the 2005 financial year, the Monitoring Committee would emphasise that compliance with the Code should be 100%. All parties concerned are responsible for ensuring that the

Code remains an effective instrument as an alternative to regulatory measures. If a company decides not to apply a best practice provision, it must give reasons for this.

At 85% (of which 15% provide an explanation), the rate of compliance with the best practice provisions on the remuneration of management board members is still relatively low. This applies in particular to local companies. The Monitoring Committee recommends that all companies improve compliance.

The Monitoring Committee believes that the increasingly standardised explanation for non-compliance with the Code is not a desirable development. This applies in particular to the relatively common statement that the company applies its own scheme rather than the Code. If the company does not give reasons for this, the Monitoring Committee does not consider it to be an adequate explanation. The company should explain why it applies its own scheme.

II. Activities of shareholders

The average attendance rate at general meetings of shareholders is 57% (50% if the companies that have issued depositary receipts for shares are disregarded). This is higher than the rates for 2005 (56% and 44% respectively). The Monitoring Committee is hopeful that the use of electronic tools, for which a legal basis has existed since 1 January 2007, will contribute to a further increase in attendance rates in the future.

Last year the Monitoring Committee recommended that corporate governance items, if any, should be placed on the agenda before the item dealing with the discharge of the management board from liability for its conduct of policy. Although compliance has risen in this respect, the Monitoring Committee is still dissatisfied with the extent to which this recommendation is followed across the board.

Compliance with best practice provisions IV. 4.1 to IV. 4.3 by institutional investors in 2005 was studied by using the database of participants in Eumedion. A different approach was chosen for 2006, partly because not all the participants in Eumedion come within the scope of the Code or section 5:86 of the Financial Supervision Act *(Wet op het financieel toezicht / Wft)*. A study has been made of compliance with the best practice provisions by the five largest institutional investors from four categories: life insurers (LI), collective investment schemes (CIS), company pension funds (CPF) and industry-wide pension funds (IWPF).

As far as the top five institutional investors in each category are concerned, the picture is as follows. The five major collective investment schemes have an average compliance rate of 87%. In the case of the five largest life insurers, this rate is only 53%. The compliance rate of the five largest company pension funds is 60%. By contrast, the industry-wide pension funds have a 100% compliance rate.

The Monitoring Committee would emphasise that compliance with the Code by institutional investors should be 100%. This is all the more the case since the compliance duty of Dutch institutional investors has been law since 1 January 2007. If an institutional investor decides not to apply a best practice provision, it must give reasons for this.

The Monitoring Committee recognises that the survey does not provide a fully representative picture. Moreover, Dutch institutional investors form only a limited part of the shareholder population of Dutch listed companies. This is one reason why a survey has been carried out at the request of the Monitoring Committee to assess how international investors view Dutch corporate governance relations. The Monitoring Committee will deal with this in its final report.

III. Internal risk management and control systems

The Monitoring Committee notes that compliance and application in the area of internal risk management has improved slightly. Nonetheless, the Committee would make a number of observations about risk reporting in the annual report. It considers that the description of the strategic, operational and financial risks as well as the legislative and regulatory risks can be improved. The Committee therefore makes a number of recommendations for describing the risk profile and the internal risk management and control system.

Description of the risk profile

The description of its risk profile outlines the risks the company encounters in implementing its strategy. The company also states what risks it is prepared to take in order to achieve its objective and if possible quantifies them by means of a sensitivity analysis.

The description should in any event:

- explain the main risks related to the company‘s strategic objectives and its appetite for risks;
- describe the main strategic, operational, financial, legislative/regulatory and financial reporting risks of the company, including in any event the qualitative impact of these risks;
- contain a sensitivity analysis of the identified risks if it is reasonable to expect such an analysis in the light of the best practices in the sector concerned.

Description of the internal risk management and control system

The description of the internal risk management and control system should indicate what measures the company has taken to control the identified risks. It should deal not only with the system itself but also how it is embedded in the organisation. It is recommended that the following points be discussed:

- the risks which are managed by the internal risk management and control system and, if necessary, the reference model used to configure the system;
- the organisation of the internal risk management and control system and how it is embedded in the organisation;
- the results of a periodic evaluation of the internal risk management and control system and, in so far as applicable, the improvement measures taken as a result.

IV. Remuneration of management board members

The empirical survey by the University of Groningen and Towers Perrin of management board remuneration and the relationship between this remuneration and corporate performance has produced the following results:

- the level of remuneration of Dutch management board members does not differ from that of their counterparts in other European countries;
- the total remuneration of Dutch management board members was significantly higher in 2006 than in 2002, which is in keeping with European practice. During the same period the companies too have grown in size. The remuneration level in large companies is higher and rises faster than in small companies. The remuneration of the chairman of the management board appears to rise faster than that of the other board members. An important component of the increase in total remuneration (ex post) is the increase in the value of (conditional) awards of shares;
- there is a fairly wide variety of performance criteria; financial criteria are applied significantly more frequently than qualitative criteria;
- the role of the remuneration committee is crucial in the negotiating process and in agreeing contract terms with a management board member. The remuneration committee has the best chance of negotiating a remuneration contract successfully if its members have a sufficient knowledge of the company's organisation and of the remuneration instruments and if the committee is independent of the management board;
- there is a positive correlation in the Netherlands between shareholder value and the level of the overall remuneration; the cash bonus reflects a positive correlation with turnover and profitability. The award of shares and options is closely related to the creation of (relative) shareholder value;
- the majority of management board members whose employment terminates early receive a severance payment; this is often in excess of one year's salary, which is the basic assumption in the Code. Internationally, severance pay is generally higher than one year's salary.

The Monitoring Committee considers that self-regulation (guidance) is in principle a better instrument than legislation for influencing the level and structure of remuneration. This is also consistent with the purpose of the Code. However, self-regulation can be a serious alternative for legislation only if everyone makes an effort to comply with the code: in other words, self-regulation requires self-discipline.

The supervisory board is responsible for formulating the remuneration policy and determining the individual remuneration of management board members. The Monitoring Committee recognises that the supervisory board (i.e. the remuneration committee) has a difficult job. To assist the supervisory board the Monitoring Committee has produced guidance in the form of recommendations. These recommendations deal with:

Process and role of the remuneration committee

In its report of December 2006 at the Monitoring Committee described the independence of both the remuneration committee and any external remuneration consultant in relation to the management board as a key feature of the process for determining remuneration. Supervisory board members should therefore be sufficiently capable of providing counterweight to international customs and practices and to the opinions of consultants that tend to increase the complexity of remuneration contracts.

In order to support the independence of the remuneration committee, the Monitoring Committee makes the following recommendations:

- The remuneration committee itself (not the remuneration consultant) should adopt the principles for the remuneration policy (including the use and composition of the peer group, the ratio of fixed to variable and short-term to long-term remuneration and the ratio of the remuneration of the chairman to that of other members of the management board).
- The remuneration committee (not the remuneration consultant) should take the initiative in determining the performance criteria. These performance criteria are derived from the indicators that are periodically used in assessing corporate and management board performance.
- If the remuneration committee makes use of these services of a consultant who provides a benchmark for determining the level of management board remuneration, this consultant should be independent of the management board. It follows that the consultant concerned may accept other assignments from the company only in very exceptional circumstances and with the prior consent of the supervisory board (or the remuneration committee). When the occasion arises, this does not prevent another consultant working for the same organisation from accepting an assignment from the company, provided that there is sufficient assurance that the two consultants operate independently of each other.
- With the exception of an intake interview at the start of the process the remuneration consultant should not have any contact with the management board members, unless the remuneration committee explicitly requests this.
- The discussions and negotiations with the management board members should be conducted exclusively by the remuneration committee (or its chairman), possibly in the presence of the chairman of the supervisory board and the remuneration consultant.

If remuneration other than fixed remuneration is to be awarded, the supervisory board should arrange for scenario analyses to be carried out periodically in order to identify any undesirable effects of the remuneration instruments that are employed. Account should be taken in this connection of special developments in the equity markets, the performance of the company and the performance of any peer group companies. The effects of possible mergers and acquisitions should also be taken into consideration. The scenario analysis should also cover voluntary and involuntary termination of employment.

The supervisory board should apply internal guidelines for a remuneration ceiling on the total remuneration package of the management board members. This remuneration ceiling relates to the fixed salary, the short-term variable pay and the value of the long-term variable pay on the date of grant. The supervisory board should state in the remuneration report whether a remuneration ceiling is applied internally.

If the variable pay is granted on the basis of incorrect financial or other data, the supervisory board should have the possibility of adjusting it, and the company should be entitled to reclaim from the management board member the variable pay granted on the basis of the incorrect data. This claw back clause should be disclosed.

In the case of new awards of variable pay to management board members based on quantified performance criteria, the supervisory board should be able to alter this in relation to the level of previous years if this would, in its opinion, produce unreasonable results, taking account of the remuneration policy adopted by the shareholders. The supervisory board should also have the power to alter existing conditional awards of variable pay based on quantified performance criteria if unaltered application would, in the opinion of the supervisory board, produce an unreasonable and unintended result. The supervisory board should exercise these powers only as a last resort. A passage to this effect is included in new remuneration contracts with management board members.

In order to prevent unlimited and unintended rises in variable pay, the supervisory board should ensure that when short-term and/or long-term variable remuneration is granted, each variable component [can] does ?not exceed a given maximum percentage of the fixed gross salary. The policy pursued by the supervisory board with regard to the maximum ratio between fixed and variable remuneration should be disclosed by the company.

Structure; relationship between remuneration and corporate performance

Principle II.2 of the Code provides that the structure (and level) of the remuneration that the management board members receive should be such that the company can recruit qualified managers. In so far as the remuneration consists of a fixed and a variable part, the variable part should be related to previously determined, measurable and influenceable short-term and long-term objectives. The variable part of the remuneration is designed to reinforce the board members' commitment to the company and its objectives.

In its report of December 2006 the Monitoring Committee recommended that the remuneration policy and its results should be presented to the meeting of shareholders in clear and understandable terms. It is the job of the supervisory board to arrange for this; this means that it should monitor the complexity of remuneration contracts.

The Monitoring Committee notes that there is no single clear practice regarding accounting for management board remuneration in the financial statements and annual report. To have good information about the actual remuneration of management board members, it is necessary to know both:

- the costs to the company of the remuneration, and
- all unconditional remuneration actually received by the management board member.

In its final report, the Monitoring Committee will examine possible ways of accounting for management board remuneration in a clear and transparent manner.

Best practice provision II.2.7, which regulates the maximum remuneration in the event of dismissal, should be extended to include all reasons for termination of employment. On the basis of best practice provision II.2.11 the main elements of the agreement reached with the management board member should be disclosed immediately.

- The Monitoring Committee recommends that severance pay be added to the list of elements that must be disclosed immediately, unless this would be contrary to an overriding interest of the company.
- The severance pay agreed in contracts with management board members should be in accordance with the remuneration policy adopted. When a management board member leaves the company, the remuneration committee should provide specific information about the severance pay in the report to the shareholders.

The Monitoring Committee recommends that the conditions for change-of-control clauses in contracts with management board members and for other prospective payments to management board members (whether in the form of securities or otherwise) should be immediately disclosed. Such information should also be provided in the event of a resolution or motion of the management board in respect of a takeover or other important change in the nature of the company which is presented to the general meeting of shareholders and may result in the applicability of the compensation clause.

- Compensation for a change of control, whether or not granted under a term of the employment contract, should be based on a scheme included to this effect in the remuneration policy adopted.
- If a motion whose adoption result in a change-of-control clause becoming applicable is submitted by the management board to the general meeting for approval, the specific consequences of the application of the clause, should the motion be adopted, must be stated in the explanatory notes

Best practice provision II.2.10 provides, inter alia, that the remuneration report should, if applicable, describe the performance criteria and provide an explanation of the criteria chosen. In its reports of December 2005 and December 2006 the Monitoring Committee recommended in particular that the relationship between 'remuneration and performance' should be made visible not only ex ante but also ex post. However, as a result of the variety of performance criteria used, the transparency of the

criteria has diminished. Nor is the transparency enhanced by the often fairly general way in which qualitative objectives are described.

The Monitoring Committee considers that the relationship between the performance criteria and the strategic aims of the company should be disclosed in the remuneration report. The performance criteria should be sufficiently definite, quantified and specific for the extent of the true ambition to be apparent from them.

On the basis of best practice provision II.2.12 one-off payments should be explained in the remuneration report. The Monitoring Committee recommends that if the company makes one-off (short-term) payments to management board members (other than the annual bonus), this should be based on a scheme included to this effect in the remuneration policy adopted.

V. Diversity in the composition of supervisory boards.

The Code provides that the supervisory board should be composed in such a way that the members are able to operate independently of each other, the management board and any sectional interest. In addition to expertise, independence is a crucial requirement for a properly functioning supervisory board. An important way of enabling the supervisory board to act independently is to ensure that it is of diverse composition. In its opinion of May 2007 submitted to the government, the Monitoring Committee recommended that the supervisory board should try to ensure that its composition is diverse.

The Monitoring Committee has defined five aspects of diversity in the composition of the supervisory board: gender, nationality, age, expertise and social background. It recognises that the gender of a supervisory board member need not exclusively be regarded as an aspect of diversity, but is of the opinion that the representation of women in top positions should also be viewed in the context of equal treatment. The diversity perspective implies that women have a different attitude to business than men.

Recently attention has focused specifically on women in top positions. Some people have advocated that the Code should specify a quota for women on supervisory boards. The Monitoring Committee notes that the percentage of women on the supervisory boards of Dutch listed companies is relatively low. It points out that companies have a direct interest in encouraging women to take top positions. An important determinant of success for companies is their ability to attract and retain talent. If half of the population are underutilised, this means that half of the available talent is underutilised. The Monitoring Committee therefore invites supervisory board members and other stakeholders to examine how the position of women in the private sector can be improved. However, on the basis of its remit and the survey findings, the Monitoring Committee does not see any reason to include a quota in the Code for the number of women on supervisory boards.

A modern company can therefore be expected to develop, apply and account for a diversity policy. The diversity policy is reflected, among other things, in the profile and appointment policy for the supervisory board. The Monitoring Committee considers it important for the supervisory board to have a diverse composition, because this can enhance its independence and quality. Both the selection and appointment committee and the chairman of the supervisory board play an important role in determining the composition of the team of supervisory board members and its functioning.

Article III.5.13 of the Code regulates the duties and activities of the selection and appointment committee of the supervisory board. The Monitoring Committee considers it important that the selection and appointment committee should take explicit account in its work of the diversity policy formulated by the company.

Greater diversity in the supervisory board's composition can be achieved either by increasing supply or by encouraging demand. The point is that supervisory boards should become aware of the availability of candidates whose nomination is not immediately obvious. People who are below the level of the management board of large companies or other civic organisations can also be suitable candidates for membership of the supervisory board of smaller companies. A more open process of recruiting candidates for supervisory board membership would help to bring vacancies to the attention of potential candidates and bring potential candidates to the attention of the board. Companies could also give management board members and employees more scope to accept supervisory board memberships with other companies, provided this does not conflict with their own interests as employer. The survey shows that the average age of supervisory board members is 62. The Monitoring Committee invites supervisory boards to aim for greater diversity in terms of age as well.

Good use of the instrument of evaluation can also influence the diversity of composition. Serious periodic evaluation can improve the supervisory board's functioning and, when a supervisory board member is replaced, the board can expressly decide to aim for greater diversity in the interests of improving quality.

The Monitoring Committee would point out, by the way, that the quality of the functioning of the supervisory board is determined not only by diversity but also by expertise, personal involvement and continuity as well as effectiveness. It would not therefore seem worthwhile increasing the number of supervisory board members simply in order to increase diversity. The Monitoring Committee would also point out that diversity should not be at the expense of team spirit in the supervisory board.

In the light of the above, the Monitoring Committee makes the following recommendations:

1. the Monitoring Committee recommends that the supervisory board (at the suggestion of the selection and appointment committee) should expressly deal in its profile with the diversity aspects relevant to the company and explain how they are applied in practice;
2. the Monitoring Committee recommends that candidates for new vacancies on the supervisory board should also be recruited outside the existing networks;

3. the Monitoring Committee recommends that the supervisory board should aim for a mixed composition. The diversity of its composition could be increased above all in terms of gender.

VI. Future activities

The Monitoring Committee will publish its final report in the spring of 2008. In this report the Monitoring Committee will take stock of three years' compliance with the Code. The Monitoring Committee will also examine whether consideration should be given to modifying the code, and if so what parts of the code, and how the monitoring should be continued.

In its final report the Monitoring Committee will also consider current developments in the field of corporate governance, such as takeover battles, the supervision function in the case of listed companies and the development of the market for corporate control.

The report will also deal with the survey of the views of (international) investors on the Dutch corporate governance relationships, which is currently being carried out by the Amsterdam Centre for Law & Economics (ACLE) and Rematch BV. Finally, the Monitoring Committee will discuss in its final report the possibilities for achieving a clear and transparent manner of reporting the remuneration of management board members.

Introduction

The Corporate Governance Committee (also known as the 'Tabaksblat Committee') adopted the Dutch Corporate Governance Code (the Code) on 9 December 2003. The Code was drawn up at the request of Euronext Amsterdam, the Netherlands Centre of Executive and Supervisory Directors (NCD), the Foundation for Corporate Governance Research for Pension Funds (SCGOP), the Association of Stockholders (VEB), the Association of Securities-Issuing Companies (VEUO) and the Confederation of Netherlands Industry and Employers (VNO-NCW) and at the invitation of the Minister of Finance and the Minister for Economic Affairs. The Code came into force with effect from the financial year starting on 1 January 2004.

The Minister of Finance, acting partly on behalf of the Minister of Justice and the State Secretary for Economic Affairs, set up the Corporate Governance Code Monitoring Committee (the Monitoring Committee) on 6 December 2004. The Monitoring Committee's official terms of reference are to help ensure that the Code is practicable and up to date and to monitor compliance by Dutch listed companies and institutional investors. It has therefore been agreed that the Monitoring Committee should publish a compliance report annually. The first two reports were published in December 2005 and December 2006. You have before you the third report.

The report relates to the 2006 financial year, which was the third financial year in which Dutch listed companies were obliged to comply with the Code. During the general meetings the shareholders were able to express their views on the actual application of the Code and on the explanation given in cases where companies departed from the provisions of the Code.

The structure of the report is the same as that of last year's report. Part 1 contains the findings on compliance with the Code and major international developments. The surveys carried out on behalf of the Committee by the University of Groningen (into compliance with the Code by listed companies) and Rematch BV (into activities of shareholders), together with the market consultations held by the Committee, provide the basis for the findings on compliance in this part.

Part 2 contains a more detailed examination of specific issues. As in previous years, the focus is on internal risk management and remuneration. On behalf of the Monitoring Committee the University of Groningen has studied the relationship between management board remuneration and corporate performance. This year the Monitoring Committee also specifically deals with diversity in the composition of supervisory boards. At the request of the Monitoring Committee the University of Groningen has studied how the diversity in the composition of the supervisory boards of Dutch listed companies has changed. On behalf of the Committee Ms T.A. Maas-de Brouwer and Mr A.

Westerlaken have also interviewed 29 supervisory board members about the functioning of the boards and about the usefulness of diversity in board composition.[1]

In May 2007, the Monitoring Committee submitted an opinion to the government which was prompted in part by the more active role played by shareholders since the introduction of the Code. The Monitoring Committee recommended that despite some high profile cases of shareholder activism there were no grounds for fundamentally changing the Dutch stakeholder-based corporate governance system, since it still operated adequately. The Monitoring Committee stated that it was important for Dutch companies to remain attractive for investors, particularly foreign investors, and at the same time avoid becoming the involuntary vehicle of short-term investment strategies in the financial markets. According to the Monitoring Committee, greater use of (structural) anti-takeover measures was not an adequate means of achieving this objective. However, the Monitoring Committee did consider that further rules were necessary to regulate the company-shareholder relationship in order to ensure that the processes involving the management board, supervisory board and shareholders (i.e. the general meeting of shareholders) are conducted smoothly and that the best possible balance is achieved between the various interests. In its advisory report the Monitoring Committee thus drew up rules in the form of more detailed versions of some principles of the Code and made recommendations to the legislator. The government has largely adopted the recommendations.[2] A bill is currently being prepared to implement them.

No change in the composition of the Committee has occurred in the past year. However, Professor S.H.M.A. Dumoulin has assisted the Monitoring Committee as advisor owing to the limited availability of Professor A.F. Verdam.

The Monitoring Committee's heartfelt thanks are due to everyone who has provided it with information and cooperated with the surveys and interviews conducted on its behalf. Without their efforts it would not have been possible to make a proper assessment of compliance with the Code and of developments in the field of corporate governance.

Professor J.M.G. Frijns,
Chairman of the Monitoring Committee
Corporate Governance Code

[1] The survey reports of the University of Groningen and Rematch BV can be consulted on the Monitoring Committee's website (www.commissiecorporategovernance.nl). It should be noted for the record that the Committee has based its report on the survey commissioned by it. However, the Monitoring Committee is not responsible for the contents of these surveys.

[2] Letter of the Minister of Finance of 19 June 2007, Parliamentary Papers 2006/07, 31 083, no. 1.

Part 1 - Findings

Chapter 1. Compliance with the corporate governance code by listed companies

1.1 Introduction

Listed companies incorporated in the Netherlands have been required to comply with the principles and best practices of the Code since 1 January 2005. The Monitoring Committee understands compliance to mean the unconditional application of a principle or best practice or the inclusion of an explanation in the annual report of the company as to why a provision is not applied (known as the 'apply or explain' principle).[3] If a listed company does not therefore apply a principle or best practice provision, it can still comply with the Code by explaining this in its annual report.

As in the two previous financial years the Monitoring Committee has analysed how companies complied with the Code in the 2006 financial year. For this purpose it has commissioned a survey by the University of Groningen. This chapter reports on the results.

The compliance survey relates to the principles and best practice provisions with which the company – or rather its management board or supervisory board – is required to comply. Specific attention is paid this year to compliance with the best practice provisions on internal risk management and the remuneration of management board members.

Section 1.2 explains the survey approach. Section 1.3 gives a general overview of compliance with the Code in the 2006 financial year. Section 1.4 reviews the explanation given for non-application of provisions of the Code and includes a quantitative analysis. Section 1.5 gives a qualitative analysis of the explanation. Section 1.6 deals with the Code's provisions on the subject of internal risk management. Section 1.7 examines in more depth the provisions relating to the remuneration of management board members. Finally, section 1.8 identifies some points for attention. The compliance survey report of the University of Groningen can be consulted on the Monitoring Committee's website (www.commissiecorporategovernance.nl).

[3] The meaning given in this report to the terms 'apply' and 'comply' coincides with their use in the Code. It should be noted in this connection that this meaning differs from their meaning in the explanatory memorandum to Article 3 of the Decree of 23 December adopting further rules governing the content of the annual report (Bulletin of Acts and Decrees 2004, no. 747). In the explanatory memorandum the term 'apply' is used to mean compliance with a given best practice code or the provision of an explanation in the event of a departure from the provision. The survey report of the University of Groningen, on which this chapter is based, adopts the meaning given to the term in the Decree of 23 December 2004.

1.2 Survey approach

The survey of compliance with the Code in the 2006 financial year covers all Dutch AEX, AMX and AScX companies and local companies, except those for which the necessary information was not publicly available in time (September 2007). The total number of Dutch listed companies in the survey is 122.

Table 1.1

	2006	2005
AEX	24	24
AMX	22	22
AScX	24	23
Local companies	52	50
Total	*122*	*119*

The main source of information for the survey is the data on Code compliance in the companies' annual reports. Under the Decree adopting Further Rules on the Contents of Annual Reports[4] a company is required to provide information in its annual report about compliance with the principles and best practice provisions and to give a reasoned explanation if it does not apply any part of the Code. The decree does not contain any rules on the content of the notice in the annual report or, in the event of non-application, the reasons to be given, these being matters left to the company and its shareholders.

For the purposes of the survey method this system means first of all that compliance must be assumed in situations where no information is given about compliance or non-compliance. What is recorded is whether something is applied or explained. No account is taken of the quality of the explanation. In view of this limitation, the Monitoring Committee has once again requested the University of Groningen to prepare a qualitative as well as a quantitative analysis of the explanations for derogating from the Code. However, this does not alter the fact that analysing and assessing the quality of the explanation is, in principle, a matter for the company and its shareholders.

Finally, the Monitoring Committee would note that as in previous years it has benefited greatly from other reports on Code compliance commissioned by organisations other than the Committee. The findings of various interest groups and experts in these reports have helped to broaden the Committee's understanding.

[4] Decree of 23 December 2004 adopting Further Rules on the Content of the Annual Report (Bulletin of Acts and Decrees 747).

1.3 General picture

Owing to the complex and varied nature of provisions of the Code and its parts, any conclusions about Code compliance can only be of a very general nature. Given this limitation an (unweighted) average compliance rate for all Code provisions has been determined. The total average compliance with the Code in 2006 was 95%. This was fractionally lower than in 2005. Compliance with the Code therefore appears to have stabilised to some extent. The average application rate for each provision of the Code is approximately 90%. The average explanation rate for each provision is about 5%.

Table 1.2

	2006 financial year			2005 financial year		
	Compliance	***Application***	***Explanation***	***Compliance***	***Application***	***Explanation***
All companies	**95%**	90%	5%	96%	92%	4%
AEX	**96%**	92%	4%	97%	94%	3%
AMX	**96%**	92%	4%	97,5 %	91%	3,5%
AScX	**95%**	90%	5%	97,5%	93%	4,5%
Local companies	**93%**	87%	6%	92%	86%	6%

<u>Compliance with parts of the code</u>

Table 1.3 contains an overview of the application and explanation of the different chapters and parts of the Code (at the level of principles). The application rate and explanation rate together form the compliance rate.

Table 1.3

Chapter of the code		AEX		AMX		ASCX		Local		Total	
		A	*E*	*A*	*E*	*A*	*E*	*A*	*E*	A	E
I.	**Compliance with and enforcement of the Code**	*100*	*0*	*100*	*0*	*97*	*0*	*97*	*0*	**98**	**0**
II.	**The management board**										
II.1	Role and procedure of the management board	*90*	*7*	*87*	*3*	*85*	*3*	*80*	*5*	**84**	**5**
II.2	Management board remuneration	*72*	*15*	*70*	*14*	*74*	*13*	*63*	*15*	**70**	**15**
II.3	Conflicts of interest	*99*	*1*	*96*	*0*	*100*	*0*	*93*	*2*	**96**	**1**
III.	**Supervisory board**										
III.1	Role and procedure of the supervisory board	*93*	*0*	*92*	*0*	*92*	*0*	*84*	*1*	**89**	**0**
III.2	Independence of the supervisory board	*85*	*10*	*84*	*16*	*88*	*10*	*84*	*11*	**85**	**12**
III.3	Expertise and composition of the supervisory board	*93*	*4*	*95*	*3*	*95*	*3*	*88*	*6*	**92**	**5**
III.4	Role of the chairman of the supervisory board and the company secretary	*92*	*6*	*95*	*3*	*96*	*4*	*83*	*14*	**89**	**8**
III.5	Composition and role of the key committees of the supervisory board	*94*	*3*	*94*	*1*	*92*	*3*	*89*	*4*	**92**	**3**
III.6	Conflicts of interest of the supervisory board	*88*	*1*	*91*	*2*	*97*	*1*	*92*	*2*	**93**	**1**
III.7	Supervisory board remuneration	*97*	*3*	*94*	*5*	*94*	*5*	*90*	*8*	**93**	**6**
III.8	*One-tier management structure*	*75*	*25*	*n/a*	*n/a*	*n/a*	*n/a*	*100*	*0*	**81**	**19**
45IV.	**The shareholders and general meeting of shareholders**										
IV.1	Powers of the general meeting	*97*	*0*	*94*	*1*	*83*	*3*	*88*	*4*	**90**	**2**
IV.3	Provision of information to the general meeting	*97*	*2*	*95*	*3*	*89*	*8*	*74*	*7*	**85**	**6**
V.	**The audit of the financial statements, the internal audit and the position of the external auditor**										
V.1	Financial reporting	*100*	*0*	*98*	*0*	*98*	*0*	*99*	*0*	**99**	**0**
V.2	Functioning of the external auditor	*98*	*0*	*98*	*0*	*100*	*0*	*100*	*0*	**99**	**0**
V.3	Internal audit function	*91*	*0*	*76*	*10*	*55*	*45*	*64*	*36*	**70**	**25**
V.4	Relationship and communication of the external auditor with the organs of the company	*96*	*0*	*100*	*0*	*100*	*0*	*100*	*0*	**99**	**0**

n/a = not applicable

For the most part, the rates of compliance with individual chapters and parts of the code (i.e. application + explanation) in the 2006 financial year were between 90% and 100%. In other words, the rate of compliance was generally high. Compliance with the provisions on management board remuneration was relatively low (85%). The rates of compliance with parts II.1 (role and procedure of the management board) and III.1 (role and procedure of the supervisory board) are lower than

average (89%). Parts of the Code in respect of which explanations of non-application are given relatively often are the internal audit function (25%), the one-tier management structure (19%), management board remuneration (15%) and the independence of the supervisory board (12%). The rate of application is relatively low in the case of management board remuneration and the internal audit function (both 70%).

Chapter 1: Compliance with and enforcement of the Code

Chapter 1 of the code focuses on the manner of compliance and enforcement. Principle I provides that the management board and supervisory board are responsible for the corporate governance structure of the company and compliance with the Code. They are accountable for this to the general meeting of shareholders. The chapter also contains two best practice provisions relating to the presentation of the broad outline of the corporate governance structure in the annual report (I.1) and the inclusion in the agenda of the general meeting of shareholders of any substantial change in the corporate governance structure of the company (I.2).

The rates of compliance with and application of the best practice provisions of this chapter are high (98%).

Transparency of corporate governance section

The survey of the 2006 financial year includes a specific analysis of the characteristics of the corporate governance section in the annual report. This is because the corporate governance section of annual reports in the 2005 financial year did not always clearly show what best practice provisions had not been applied and for what reasons.

Generally, it can be concluded that the 2006 annual reports provide clearer information than the 2005 annual reports on why best practice provisions are not applied. Various companies that gave narrative accounts of the non-application of best practice provisions as recently as last year have this year presented a clear, numbered list of best practice provisions they do not apply. Moreover, every company has dealt with compliance with the Code in its annual report. The 2005 annual reports of three companies contained not a single reference to compliance with the Code.

Which provisions were not applied is clearly and immediately apparent from the annual reports of 88 of the 122 companies in the survey. Five companies explicitly stated that they applied all the best practice provisions of the Dutch Corporate Governance Code. This was the same number as last year. In addition, 64 companies presented a numbered list of the provisions they did not apply. This was substantially higher than in the 2005 financial year (55 of the 127). Eighteen companies provided narrative information on whether or not they applied best practice provisions and in doing so referred

to the relevant best practice provisions. Eight companies referred to a different document available on their website for information about compliance with best practice provisions.

In the case of 16 of the 122 companies studied, the information given in the annual report – or in documents to which the annual report referred – about compliance with best practice provisions was not entirely clear. This was a considerable improvement on the previous survey (30 of the 127). Eleven companies merely gave narrative information about which parts of the Code they did not apply, without referring to specific best practice provisions (compared with 20 in 2005). Something similar applies in the case of the five companies that chose to describe a number of derogations without specifying the relevant best practice provisions.

Chapter II: the management board

This chapter is divided into three parts, namely:
II.1 role and procedure of the management board;
II.2 amount and composition of the remuneration of the management board members;
II.3 conflicts of interest
Part 1 has seven best practice provisions, part 2 has fourteen and part 3 has four.

Compliance with the provisions on the role and procedure of the management board (II.1) averaged 89%. This was 6% lower than in the 2005 financial year. Compliance with the part on management board remuneration (II.2) was 85%. This was 6% higher than in the 2005 financial year. A relatively large part of this percentage was attributable to explanations for non-application (15%). The rate of application of the part on management board remuneration was 70% (73% in the 2005 financial year). Compliance with the part on conflicts of interests (II.3) remained high (97%).

Chapter III: supervisory board

This chapter has eight parts, namely

- III.1 role and procedure;
- III.2 independence;
- III.3 expertise and composition;
- III.4 role of the chairman of the supervisory board and the company secretary
- III.5 composition and role of three key committees of the supervisory board;
- III.6 conflicts of interest;
- III.7 remuneration;
- III.8 one-tier management structure.

The rates of compliance in respect of all these parts varied between 89% (III.1 role and procedure of supervisory board) and 100% (III.8 one-tier structure). The explanation rates of 12% for the independence of the supervisory board (III.2) and 19% in the case of one-tier management structure (III.8) were higher than average.

<u>Chapter IV: the shareholders and general meeting of shareholders</u>

Chapter IV of the Code deals with the general meeting of shareholders. Around half of the best practice provisions of chapter IV relate to the shareholders. These provisions will be dealt with in chapter 2 (shareholders) of this report. The results of parts IV.1 (the shareholders and general meeting) and IV.3 (provision of information to the general meeting of shareholders) relate to the company.

The average compliance rates of 92% (IV.1) and 91% (IV.3) were slightly lower than the total average compliance rate of 95%. Rates that were particularly divergent were those for the application of part IV.3 (provision of information to the general meeting of shareholders) by local companies (74%) and their explanation for its non-application (7%).

<u>Chapter V, The audit of the financial reporting and the position of the internal audit function and of the external auditor</u>

This chapter consists of four parts:

V.1 Financial reporting

V.2 Role, appointment, remuneration and assessment of the functioning of the external auditor

V.3 Internal audit function

V.4 Relationship and communication of the external auditor with the organs of the company

The average rate of compliance with parts V.1, V.2 and V.4 was 99%, which was lower than in the 2005 financial year.

The lower rate of compliance (95%) with part V.3 (internal audit function) is noteworthy. This was mainly due to the lower rates of application by AEX, AMX and AScX companies. These were on average 9%, 14% and 11% lower respectively.

1.4 Explanation for non-application of best practice provisions

This section deals with the explanations given by companies in situations where the best practice provisions were not applied (or not fully applied) in the 2006 financial year. The researchers used by the Committee found in total 742 instances (in annual reports or on websites) in which a company explained why it was not applying a best practice provision. This means that each company gave explanations for not applying about 6 of the 102 best practice provisions relevant to this part of the report. In the 2005 financial year companies gave explanations for five provisions on average.

Table 1.4

Provision		2006		2005	
		Number	*Top 10 Position*	Number	*Top 10 Position*
II.1.1	Maximum term of appointment of management board members	86	1	94	1
II.2.7	Maximum severance pay of management board members	83	2	78	2
II 2.6	Regulations concerning ownership of and transactions in securities by management board members	56	3	52	3
III. 7.3	Regulations concerning ownership of and transactions in securities by supervisory board members	56	4	52	3
IV.3.1	Webcasts of analysts' meetings, presentations and press conferences for all shareholders	45	5	37	6
III.5	Composition and role of three key committees of the supervisory board	28	6	38	5
III.3.5	Maximum term of office for supervisory board members: 3 times 4 years	24	7	21	7
V. 3.1.	External auditor and audit committee involved in drawing up the work schedule of the internal auditor	23	8	15	10
III.2.1	All supervisory board members except one are independent	21	9	17	9
III.4.3	Duties of company secretary	20	10	19	8
III 5.11	Supervisory board chairman should not also chair the remuneration committee	20	10	4	>Top 10
	Total Top 10	**462**		**423**	
	Top 10's percentage of the total	**62%**		**64%**	

The four most explained best practice provisions in 2006 were also in the Top 4 in 2005. These are the provisions concerning the maximum term of office of management board members (II.1.1), the maximum severance pay for management board members (II.2.7) and the regulations concerning ownership of and transactions in securities by supervisory board members (II.2.6 and III.7.3).

The next aspect to be analysed was the arguments commonly used to explain the non-application of the five most explained best practice provisions. As in last year's survey, these arguments have been divided into a number of categories:

Table 1.5

Nature of the reason	AEX	AMX	AScX	Local	Total 2006	Total 2005
Company wishes to respect existing agreements and/or contracts	24	27	24	55	**130**	135
Company asserts that legislation and regulations and/or case law prevent compliance	5	17	12	29	**63**	49
Company points out that the derogation is temporary and/or that it is in the process of implementing the best practice provision	6	5	3	14	**28**	40
Company points out that it has its own arrangement and states *explicitly* that this is in keeping with the spirit of the Dutch corporate governance code	2	4	1	1	**8**	11
Company points out that it has a different arrangement (and merely provides information about its own arrangement *without* giving further reasons).	48	30	32	56	**166**	81
Company considers that the provision requires a procedure that is not usual in the countries and/or sectors in which it operates	1	2	0	2	**5**	7
Company considers that the administrative and/or financial costs of implementing the best practice provision are unduly high and/or points out that the company is too small to comply with the provision	6	2	22	81	**111**	118
Company considers that the provision concerns something that is a private matter for the members of the management board or supervisory board	0	2	3	23	**28**	16
Other reasons	35	30	35	103	**203**	209
Total	**127**	**119**	**132**	**364**	**742**	**666**

The survey shows that three categories of explanation (together amounting to 54%) are commonly used.

Explanation 1: *'The company has its own, different arrangement'*

In 166 cases (22% of the total number of explanations) companies merely provided information about their own arrangement which was applied instead of the best practice provision of the Code. This was almost double the number in the 2005 financial year.

An example of this is the following explanation: 'As regards the management board, the company keeps open its options regarding the period for which a management board member is appointed in due course' (best practice provision II.1.1). The following explanation is another example: 'The standing rules of the supervisory board provide that the main elements of the contract of a new supervisory board member with the company should be stated in the next annual report to be

published' (best practice provision II.2.11). This category of explanation is used by all four categories of company. In relative terms, however, it is most frequently used by AEX companies.

Explanation 2: '*The company wishes to respect existing agreements and/or contracts*'

In 130 cases (17% of the total number of explanations) a best practice provision was not observed because the company concerned wished to respect existing contracts or agreements. This was slightly lower than in the 2005 financial year. This category of explanation too is used by all categories of company.

Explanation 3: *'The company considers that the administrative and/or financial costs of implementing the best practice provision are unduly high or points out that the company is too small to comply with the provision.'*

In 111 cases (15% of the total number of explanations) the company gave as its reason that the administrative and/or financial costs of implementing the best practice provision were unduly high or that the company was too small to comply with the provision. This last argument was applied above all by the smaller companies (the AScX companies and local companies).

1.5 Qualitative analysis of explanation given for not applying best practice provisions

As in last year's survey, the quality of the explanations given was examined. Thirty of the reasons given in the annual reports for not applying a best practice provision were assessed by reference to four quality 'dimensions'. The assessment is bound to be subjective to some extent. It should be noted that the survey does not in any way detract from the general principle that it is for the shareholders to express an opinion on the reason given for not applying a best practice provision.

Research approach

The approach adopted in the previous quality study (for the 2005 financial year) involved two people assessing the quality of all explanations used by companies. A disadvantage of this method was that general conclusions about the quality of explanations could be drawn only to a limited extent.

It was therefore decided to adopt a different approach for the 2006 financial year and have 30 situations assessed by a panel of 15 people. 11 of the panel members were studying at the University of Groningen. The other participants were members of the Monitoring Committee. The submission of a more limited number of situations to a larger panel can allow statements to be made with more certainty about the quality of the explanation.

The explained cases have been selected on the basis of the following criteria:

1. The explained best practice provision must be in the Top 10 of most explained best practice provisions in both the 2005 and 2006 financial years.
2. The explanation itself must have been used in both the 2005 and 2006 financial years.
3. There must have been a large measure of agreement or a large measure of disagreement in the 2005 survey about the quality of the explanation.

Quality dimensions examined

The explanation has been assessed by reference to four quality dimensions. This has been done on a scale of -2 to +2.

1. **Comprehensibility**: this dimension involves checking whether the explanation given is comprehensible in the sense that it sheds light on why the company is not complying with the provision.

Incomprehensible		Neutral	Comprehensible	
-2	-1	0	1	2

2. **Verifiability**: this dimension involves examining whether the explanation given is verifiable with the help of information in the public domain (website, annual report, etc.).

Unverifiable		Neutral	Verifiable	
-2	-1	0	1	2

3. **Legitimacy**: this dimension involves assessing whether the explanation is regarded as a legitimate reason for not complying with the relevant provision (*without* taking account of the specific characteristics of the company).

Not legitimate		Neutral	Legitimate	
-2	-1	0	1	2

4. **Plausibility**: this dimension resembles 'legitimacy' and classifies to what extent the explanation is deemed to be plausible for the company, taking account of the specific characteristics of the company (such as size, sector, activities, degree of internationalisation, etc.).

Implausible		Neutral	Plausible	
-2	-1	0	1	2

Survey results

The results of the quality survey are set out below in outline on the basis of the scale of -2 to +2.

Table 1.6

Overall assessment of the quality of the interpretation

	General		Students		Members	
	Average	***SD***	*Average*	*SD*	*Average*	*SD*
Comprehensibility	**0.96**	**1.22**	0.84	1.24	1.32	1.09
Verifiability	**0.16**	**1.39**	0.07	1.36	0.41	1.47
Legitimacy	**-0.26**	**1.27**	-0.05	1.27	-0.85	1.09
Plausibility	**0.13**	**1.30**	0.38	1.24	-0.59	1.17

Views on the comprehensibility of the explanations were generally positive. On the scale of -2 to +2, the panel members arrived at a collective assessment of +0.96.
Their assessment of the verifiability of the explanation they were required to assess was also slightly positive. However, their opinion of the legitimacy of the explanation was slightly negative. This negative assessment was given by both types of panel member, i.e. the students and the Monitoring Committee members. Views on the plausibility of the explanation were in general slightly positive.

Eight types of explanation were rated positively in respect of all dimensions. Three of them related to compliance with the best practice provision on the term for which management board members are appointed and the desire to honour existing contracts. It should, however, be noted that the last point does not mean that the argument – honouring existing contracts – leads to a positive assessment in respect of all explanations. The explanation that '*the existing contractual obligations are honoured and the supervisory board reserves the right to derogate from this rule in future in cases where its application would be unreasonable in the circumstances*' scored positively in terms of comprehensibility, but was given a neutral or negative rating in respect of the other dimensions. A possible cause of the difference in respect of the three situations described above is that in the last

case the supervisory board is given the freedom not to apply the best practice provision concerned even in future situations (i.e. in relation to new contracts).

An example of an explanation positively assessed by all panel members is: '*[The company] considers that – in view of its size and other factors – it would be going too far to take measures to enable all shareholders to follow in real time the meetings and presentations referred to in the best practice provision. However, it does ensure that presentations are placed on its website immediately after the close of the meetings in question.'*

Five of the six situations that produced a negative assessment (the exception being comprehensibility) related to best practice provision II.2.6 concerning the rules for management board members in respect of share ownership and transactions. This could indicate that the panel members either found it hard to imagine a situation in which non-application of the best practice provision could be justified or disagreed with the reasons given for not applying it.

The only explanation which was negatively assessed by all panel members in respect of all four parts was: *'This means, among other things, that he (the supervisory board chairman) ensures that the composition of the management board meets the needs of the organisation and also that he plays a leading role in the Nomination and Remuneration Committee.'*

1.6 Internal risk management and control systems

Code provisions and recommendations of the Monitoring Committee

The management board is responsible for the adequate functioning of risk management and control systems.

The Code defines this responsibility in best practice provisions II.1.3 and II.1.4.

II.1.3 The company shall have an internal risk management and control system that is suitable for the company. It shall, in any event, employ as instruments of the internal risk management and control system:

a) risk analyses of the operational and financial objectives of the company;

b) a code of conduct which should, in any event, be published on the company's website;

c) guides for the layout of the financial reports and the procedures to be followed in drawing up the reports;

d) a system of monitoring and reporting.

II.1.4 The management board shall declare in the annual report that the internal risk management and control systems are adequate and effective and shall provide clear substantiation of this. In the annual report, the management board shall report on the operation of the internal risk management and control system during the year under review. In doing so, it shall describe any significant changes that have been made and any major improvements that are planned, and shall confirm that they have been discussed with the audit committee and the supervisory board.

In its first report the Monitoring Committee made recommendations about the application of best practice provision II.1.4. In that case the Monitoring Committee talks of 'good practice'. The Committee considers that best practice provision II.1.4 is fulfilled if:

1. as regards financial reporting risks:

- *it is declared that there is reasonable assurance that the financial reporting does not contain any errors of material importance;*
- *it is declared that the risk management and control systems have worked properly in the year under review;*
- *it is declared that there are no indications that the risk management and control systems will not work properly in the current year;*
- *any material weaknesses which are discovered in the year under review or the current year are specified, together with any changes made or improvements planned.*

2. as regards other risks (operational/strategic and legislative/regulatory risks):

- *a description of the risk management and control systems is given on the basis of the identified material risks;*
- *if applicable, material weaknesses which are discovered in the year under review are specified, together with any changes made or improvements planned.*

It should be assumed that what constitutes 'reasonable assurance' is that which would apply as such for a management board member acting with due care in the given circumstances.

Compliance in the 2006 financial year

Compliance with the best practice provisions on internal risk management was better than in the 2005 financial year. A distinction is made below between compliance with the financial reporting provisions and compliance with the provisions on operational and strategic risks and legislative and regulatory risks. At the request of the Monitoring Committee, this survey also examines the position of internal risk management in the annual report and the extent to which companies report mention using a reference model.

Financial reporting

As regards financial reporting the application of the 'reasonable degree of certainty' provision rose by 8% (compliance by 9%). Almost all AEX and AMX companies applied this part of the provision. By contrast, only a bare majority of the local companies applied this part, and about one third gave an explanation. More or less the same was true of the statement about the functioning of the system in 2006. The provision on the statement about the functioning of the system was applied by more AEX, AMX and local companies in 2006 (rise of 21%, 5% and 11% respectively), but by fewer AScX companies (fall of 9%). Both parts were applied by 93 of the 121 companies. 78 companies in total included a statement about the expected functioning of the system. The application of the part of the provision dealing with the 'statement about expected functioning' rose by 17% (AEX companies), 19% (AMX companies) and 9% (local companies), but here too there was a decline in the application by AScX companies (-4%). The results of compliance in the 2006 financial year are shown in table 1.7.

Table 1.7

Best practice provision II.1.4 as regards financial reporting				
	Application	Explanation	Non-compliance	n
- Reasonable degree of certainty	93	8	21	122
- Statement about functioning in 2006	93	6	22	121
- Statement about expected functioning	78	7	36	121
- Deficiencies mentioned	118	2	1	121
- Improvements made	117	1	0	118
- Planned improvements	118	0	0	118

Operational and strategic risks and legislative and regulatory risks

The number of descriptions of operational and strategic risks rose slightly in the case of AEX and AScX companies (by 4% and 9% respectively), remained constant in the case of AMX companies and fell slightly in the case of local companies (by 4%). Almost all AEX, AMX and AScX companies provided a description. 36 of the 51 local companies in the survey gave a description and two provided an explanation. In total, 101 of the 121 companies in the survey gave a description of the operational and strategic risks. Table 1.8 shows the results of compliance in the 2006 financial year.

Table 1.8

Best practice provision II.1.4 as regards operational/strategic risks:				
	Application	Explanation	Non-compliance	n
- Description	101	3	17	121
- Deficiencies mentioned	121	0	0	121
- Improvements made	121	0	0	121
- Planned improvements	121	0	0	121

The number of descriptions of legislative and regulatory risks rose in the case of AEX, AScX and local companies (by 8%, 9% and 3% respectively), and remained constant in the case of AMX companies. In total, 83 of the 121 companies in the survey gave a description of the legislative and regulatory risks.

Place of description of internal risk management and control systems

Most companies (51) placed the description of the internal risk management system in the report of the management board or devoted a separate chapter to it in the annual report (39). Eight (local) companies gave no information about this.

Reference model

Most of the companies (67) did not mention a reference model in describing the system (43 of the 67 are local companies). Where a reference model was mentioned, it was usually COSO Integrated Internal Control Framework-I (39 companies). COSO-II was mentioned 16 times.

Information about structure of the system

Three quarters of the companies provided information about the structure of the risk management system used by them. Local companies in particular tended not to provide this information.
Two thirds of the companies described the functioning of the system in positive terms and 9 companies used a negative formulation.
Some companies (19) referred to limitations on the view of the management board on the operation of the system. These were mainly AEX companies (13).

1.7 Remuneration of management board members

As in the report on the 2005 financial year, the 2006 survey deals specifically with the best practice provisions relating to the remuneration of management board members (part II.2). As already stated in section 1.3, the rate of compliance with the best practice provision on management board remuneration is relatively low. These sections describe compliance with the best practice provision on management board remuneration. A table has been included for some provisions. The separate survey of the relationship between management board remuneration and corporate performance is dealt with at length in chapter 5 of this report.

Remuneration report

Provision II.2.9 states that the remuneration report of the supervisory board should contain an account of the manner in which the remuneration policy was implemented in the past financial year (i.e. 2006), and of the remuneration policy for the next financial year and subsequent years. It transpires that 114 of the 122 companies published the remuneration report for the financial year in the annual report or separately on their website. No report was provided by eight companies (seven of them local companies).

Structure of the remuneration

The first three parts of best practice provision II.2.10 concern the structure of the remuneration of management board members. Part (a) deals with the statement in the remuneration report of the relative importance of the variable and non-variable remuneration components and the reasons for this. 109 of the 115 companies in the survey mentioned the relative importance of the variable and non-variable parts of the remuneration. 73 companies also gave reasons for this.

Part (b) of best practice provision II.2.10 concerns the explanation of any absolute change in the non-variable remuneration component of the remuneration. It should be noted that over a third of the companies had not altered the fixed remuneration. However, an absolute change did occur in the case of eighty companies. 35 of them failed to comply with part (b) of best practice provision II.2.10.

Part (c) of best practice provision II.2.10 of the Code concerns the inclusion in the remuneration report of the peer group of companies used to assess the amount and composition of the remuneration. 61 of the 109 companies to which this provision was relevant complied with this provision. The rate of compliance by AMX companies (11 of the 22), AScX companies (9 of the 24) and local companies (24 of the 39) was relatively low.

Options and shares

Provision II.2.1 concerns the granting of conditional options to management board members.
Table 1.9 shows that 51 of the 122 listed companies granted *conditional* options as part of the management board remuneration. 43 of the 51 companies complied with this best practice provision

(32 applied the provision and 11 did not do so but explained why). Eight companies did not comply with this provision.

Table 1.9

Best practice provision II.2.1				
Options to acquire shares are a conditional remuneration component, and become unconditional only when the management board members have fulfilled predetermined performance criteria after a period of at least three years from the granting date.				
	Application	Explanation	Non-compliance	n
AEX	13	3	0	16
AMX	4	1	1	6
AscX	9	2	2	13
Local	6	5	5	16
Total	32	11	8	51

Best practice provision II.2.2 concerns the situation in which a company grants *unconditional* options. In such cases two conditions apply: (i) the application of performance criteria when the options are granted and (ii) the application of a retention period of at least three years. 22 companies granted unconditional options. Best practice provision II 2.2 was not complied with in relation to the application of performance criteria in six cases. Nine of the 16 companies that complied with the provision did so by explaining why they did not apply performance criteria in granting the options.

Best practice provision II.2.3 concerns the granting of shares to management board members without financial consideration. 50 of the 122 companies granted shares without financial consideration. Best practice provision II.2.3 consists of the following parts: (1) retention of shares for a minimum of five years, and (ii) granting of shares dependent on achievement of predetermined targets. Most companies complied with both parts of the provision. A relatively high proportion of the AEX and AMX companies explained why they did not apply the minimum retention period.

Best practice provision II.2.4 provides that the exercise price of options should be related in a verifiable manner to the price average of the stock market price on the days prior to the granting of the options.

Table 1.10

Best practice provision II.2.4				
The option exercise price shall not be fixed at a level lower than a verifiable price or a verifiable price average in accordance with the official listing on one or more predetermined days during a period of not more than five trading days prior to and including the day on which the option is granted.				
	Application	Explanation	Non-compliance	n
AEX	15	0	3	18
AMX	5	0	1	6
AScX	10	1	2	13
Local	10	0	5	15
Total	40	1	11	52

40 of the 52 companies that had a stock option plan applied the best practice provision. Five of the 15 local companies to which this provision applies did not comply with it.

Contract term, periods of notice and severance schemes

Rules on contracts and contract terms, periods of notice and severance schemes have been included in best practice provisions II.2.10d, II.2.11 (d) and 11.2.7.

Table 1.11

Best practice provision II.2.11				
The main elements of the contract of a management board member with the company shall be made public immediately after it is concluded.				
	Scope	Explanation	Non-compliance	n
AEX	11	0	7	18
AMX	6	2	4	12
AScX	4	0	2	6
Local	4	2	8	14
Total	25	4	21	50

25 of the 50 companies that entered into a new contract with management board members applied best practice provision II.2.11 on public disclosure. Four companies explained why they did not do so. A relatively large number of companies (21) did not comply with this best practice provision.

Best practice provision 2.10d provides that a *summary* and *justification* of the company's policy on the term of the contracts with management board members, the applicable periods of notice and redundancy schemes should in any event be given. A descriptive summary of this kind was given by the majority of the companies for these three parts of the provision. Compliance with the part of the provision concerning the justification was significantly lower.

Table 1.12

Best practice provision II.2.10d				
The overview referred to in II.2.9 should in any event contain a summary and justification of the company's policy with regard to the term of the contracts with management board members, the applicable periods of notice and redundancy schemes and a statement of the extent to which best practice provision II.2.7 is endorsed.				
	Application	Explanation	Non-compliance	n
AEX				
- Justification of contract term	13	0	11	24
- Justification of periods of notice	3	0	15	18
- Justification of redundancy scheme	16	0	4	20
AMX				
- Justification of contract term	14	0	6	20
- Justification of periods of notice	4	1	3	7
- Justification of redundancy scheme	13	0	6	19
AScX				
- Justification of contract term	15	0	8	23
- Justification of periods of notice	1	0	9	10
- Justification of redundancy scheme	14	0	7	21
Local				
- Justification of contract term	34	0	12	46
- Justification of periods of notice	9	0	11	20
- Justification of redundancy scheme	18	0	14	32
Total				
- Justification of contract term	76	0	37	113
- Justification of periods of notice	17	1	38	56
- Justification of redundancy scheme	61	0	31	92

In total, 76 of the 113 companies in the survey justified the contract terms of the management board members. Only 17 of the 56 companies that gave a description of the periods of notice for management board members also gave a justification. Redundancy schemes were described by 92 companies, 61 of which also gave a justification.

Provision II.2.7 indicates that the maximum severance pay is one year's salary in the event of termination of the contract of a management board member or twice the annual salary in the case of a management board member whose contract is terminated during his first term of office.

Table 1.13

Best practice provision II.2.7				
The maximum remuneration in the event of dismissal is one year's salary (the 'fixed" remuneration component). If the maximum of one year's salary would be manifestly unreasonable for a management board member who is dismissed during his first term of office, such board member shall be eligible for severance pay not exceeding twice the annual salary.				
	Application	Explanation	Non-compliance	n
AEX	4	18	1	23
AMX	4	18	0	22
AScX	3	20	0	23
Local	12	27	2	41
Total	23	83	3	109

109 of the 122 companies in the survey had a redundancy scheme. Only three of these companies, including two local companies, did not comply with the provision. In the great majority of cases compliance with this provision consisted of explaining that the Code was not applied.

Other remuneration components

The other remuneration components include personal loans (II.2.8), redundancy schemes (II.2.10l) and special remuneration (II.2.12).

Best practice provision II.2.8 provides that a company should not give personal loans to management board members unless certain conditions are fulfilled. First of all, it should be noted that 100 of the 122 listed companies had a policy of not granting loans. 16 of the 22 companies that granted loans did so on the basis of conditions applicable to the entire workforce. Six companies operated special schemes for management board members and also explained them. Four companies did not comply with the provision in so far as it requires the approval of the supervisory board.

Best practice provision II.2.12 concerns the payment of special remuneration to members and former members of the management board. Under this provision a company is obliged to include in the remuneration report a justification of the reasons for granting such remuneration. 27 companies paid special remuneration of this kind. In 20 cases they justified the payment in the remuneration report. Seven companies did not comply with the provision.

Performance criteria

Best practice provision II.2.10 (e) concerns the provision of a description of the performance criteria for the variable part of the remuneration. 85 of the 112 companies to which this part was relevant complied with it. The role of the local companies is striking in this respect. 15 of the 42 local companies did not comply with this part of the best practice provision.

Part II.2.10 (f) requires a *justification* of the performance criteria applied. 57 of the 85 companies that described the performance criteria (see best practice II 2.10 (e)) also gave a justification. 28 companies did not do so.

In addition to a justification of the performance criteria, the provision requires a summary of the method used to determine whether the performance criteria have been fulfilled and a justification of the choice of this method. This follows from best practice provision II.2.10 (g). 55 of the 85 companies that described the performance criteria for the variable part of the remuneration of their management board members also summarised the method for determining whether the criteria had been fulfilled. The number that justified the method applied was lower. Only 36 of the 55 companies also provided a justification.

Part II.2.10 (j) concerns the provision of a declaration if any right of a management board member to options, shares or other variable remuneration components is *not performance-related.* 12 of the 21 companies concerned provided an explanation of this. The other nine companies did not comply with the provision. Five of the nine were local companies.

1.8 Points for attention

Compliance with the Code appears to have stabilised to some extent. The extent to which listed companies complied with and applied the Code in 2006 was slightly lower than in 2005. The Monitoring Committee believes that certain improvements are possible. The following specific points can be made.

- As in its report on the 2005 financial year, the Monitoring Committee would emphasise that compliance with the Code should be 100%. All parties concerned are responsible for ensuring that the Code remains an effective instrument as an alternative to regulatory measures. If a company decides not to apply a best practice provision, it should give its reasons.
- The rate of compliance with the best practice provisions on the remuneration of management board members is still relatively low at 85% (this includes 15% that provide an explanation for non-application). This applies in particular to local companies. The Monitoring Committee recommends that all companies improve compliance.
- The Monitoring Committee views the increasingly standardised explanations for non-application of the Code as an undesirable trend. This applies in particular to the relatively common statement that the company applies its own arrangement rather than the Code. If the company does not give more detailed reasons for this, the Monitoring Committee considers that the explanation is inadequate. The company should explain why it applies its own arrangement.

2. Activities of shareholders

2.1 Introduction

Under Dutch company law there is an important role not only for the management board and supervisory board but also for the general meeting of shareholders. The management board and supervisory board are accountable to the general meeting of individual shareholders for the performance of their duties. The general meeting exercises the powers to which it is entitled in determining whether to grant a discharge.

The management board and supervisory board are also accountable to the general meeting for compliance with the Code. Compliance with the principles and best practice provisions is dealt with in the annual report. If a principle or best practice is not applied, the reasons should be explained. Both the content of the section of the annual report on the company's corporate governance structure and corporate governance policy and the statement on compliance with the best practice provisions can be raised each year in the general meeting of shareholders at the initiative of the management board or of the shareholders (preamble no. 7 to the Code).

Just as in 2005 and 2006 the Monitoring Committee has examined how companies and shareholders deal in practice with the process of accounting for compliance with the Code, in particular in the context of the general meeting. The Monitoring Committee commissioned a survey by Rematch B.V. The survey relates to the general meetings of shareholders of Dutch listed companies in the 2007 financial year. Specific attention has also been paid this year to special general meetings of shareholders (in the period from 1 September 2006 to 31 August 2007) and the initial experience of how the Promotion of Electronic Means of Communication Act, which entered into force on 1 January 2007, works in practice.

This chapter outlines the findings of the Monitoring Committee. After a description of the scope of the survey in section 2.2, section 2.3 deals with some general characteristics of the general meeting such as the attendance rates, the voting and agenda items, the structure of the meeting and the addition of items to the agenda. Section 2.4 considers the questions which shareholders have raised about corporate governance and specifically about the Code. Section 2.5 examines compliance by institutional investors with the provisions of the Code applicable to them. Extraordinary general meetings (EGMs) of shareholders are dealt with in section 2.6. Section 2.7 examines the operation of the Promotion of Electronic Means of Communication Act. Section 2.9 deals with the themes of control structure and the issuing of depositary receipts for shares and, finally, section 2.9 sets out some points for attention. For the full report of Rematch, please refer to the Monitoring Committee's website (www.commissiecorporategovernance.nl).

In its opinion of May 2007 the Monitoring Committee stated that it regarded the ‘physical general meeting of shareholders as an important final link in the decision-making process of the general meeting’. The Dual-Board Company Structure Reform Act of 2004, which introduced article 2:107a of the Civil Code, granted more decision-making and co-decision-making powers to the general meeting of shareholders. The scope of these relatively new statutory powers was tested before the courts earlier this year.[5]

[5] Supreme Court, 13 July 2007, LJN BA7972 (ABN Amro).

2.2 Survey approach

The survey covered the general meetings of shareholders held in the 2007 AGM period by 89 listed companies that have their registered office in the Netherlands. The main sources of information for the survey were the minutes and lists of resolutions of the general meetings. Special attention was paid this year to EGMs and the new Promotion of Electronic Means of Communication Act.

Table 2.1 Number of general meetings studied

	2007	*2006*
AEX	21	23
AMX	17	19
AScX	17	18
Local companies	31	20
listed abroad	3	3
total	*89*	*83*

Under section 5:86 of the Financial Supervision Act which came into force on 1 January 2007, institutional investors that have their registered office in the Netherlands are obliged to give notice of compliance – in accordance with the 'apply or explain principle' – with those principles and best practice provisions of the Code that relate to institutional investors (section IV.4 of the Code).

Last year compliance with best practice provisions IV. 4.1 to IV. 4.3 by institutional investors was studied by reference to the database of participants in Eumedion. This year a different approach was chosen, partly because not all the participants in Eumedion come within the scope of the Code or come under section 5:86 of the Financial Supervision Act. The survey examined how the best practice provisions had been complied with by the five largest institutional investors from four categories: life insurers (LI), collective investment schemes (CIS), company pension funds (CPF) and industry-wide pension funds (IWPF).

2.3. General characteristics of shareholder meetings

a) Attendance

Good corporate governance requires the fully-fledged participation of shareholders in the decisions taken in the general meeting of shareholders (Code principle IV.1). By attending the meeting of shareholders either in person or represented by a proxy, a shareholder can influence the decisions made by the company and the rendering of account by the management board and supervisory board. Companies whose general meetings have a high attendance rate run less risk of being confronted with 'chance majorities'.
Just as in the past two years the survey shows attendance rates at meetings of shareholders.

Table 2.2 average attendance at general meetings of shareholders (%)

	AEX 2007	AMX 2007	AScX 2007	Local companies 2007	Total 2007	Total 2006
companies without depositary receipts	45	43	51	54	50	44
all companies (including those with depositary receipts)	52	53	67	56	57	56

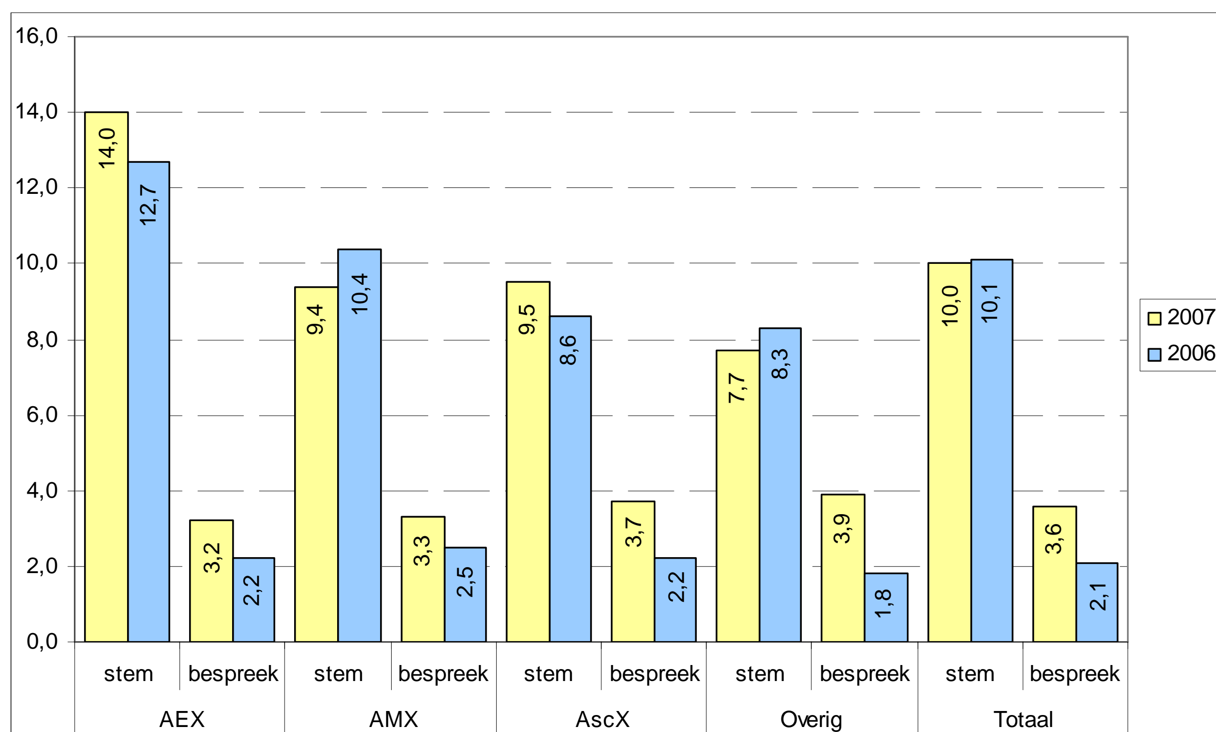
If the companies that have issued depositary receipts are disregarded, the average attendance figure was higher than in 2006 (50% compared with 44%). As regards the separate indices, the only fall in attendance has been at the general meetings of local companies that have not issued depositary receipts (from 56% in 2006 to 54% in 2007).

The average attendance rate at the general meetings of all companies in the survey (i.e. including companies that have issued depositary receipts for shares) is 57%. This was fractionally higher than in 2006 (56%) and also higher than in 2005 (54%). The AEX companies have a rather lower average attendance rate (52%) than AMX companies (53%), AScX companies (67%) and local companies (56%).

b) Voting and agenda items

The extent to which shareholders are able to vote on a resolution or debate an agenda item is a factor that determines the functioning of the general meeting as a decision-making organ of the company. As in 2006, the Monitoring Committee has therefore studied the voting and agenda items at meetings of shareholders. The votes cast by trust offices have been included. The study examines not only the number of voting and agenda items but also the voting behaviour of shareholders.

Figure 2.3 Average number of voting ("stem") and agenda ("bespreek") items



The average number of both voting items and agenda items rose in the case of AEX and AScX companies. Only the number of agenda items rose in the case of AMX and local companies. The number of voting items fell slightly in the case of the last two categories. The overall number of voting items in 2007 was at much the same level as in 2006. However, there was clear increase in the number of agenda items.

Also studied were the percentage of agenda items in respect of which votes were cast against the resolution and the percentage of votes against the resolution per agenda item.

Table 2.4 Votes against resolutions as %

	AEX	AMX	AScX	Local companies	total 2007	total 2006
% voting items with votes against	92	74	26	15	54	44
Voting items with highest average % of votes against						
dividend policy	0.00	0.00	*	16.49	13.74	0.00
authorisation for issue of shares	9.69	6.76	4.23	5.50	6.62	10.00
exclusion of right of pre-emption	10.50	3.41	2.15	0.00	5.92	6.03
management board remuneration	3.44	5.64	4.81	0.00	2.94	2.75

In total, one or more votes were cast against the resolution in the case of 54% of agenda items. This compares with 44% in 2006. The average number of votes against was 1.82%. However, the

percentage of votes against was higher in respect of a number of subjects, namely dividend policy, authorisation for the issue of shares, exclusion of rights of pre-emption on the issue of new shares, and the remuneration of management board members.

c) Organisation and agenda

The Monitoring Committee has studied how the meeting of shareholders is organised in the case of the companies in the survey (i.e. manner of communication, language of communication and manner of voting) and also what items were put on the agenda.

Webcasting

The proceedings at the meetings of shareholders of 36% of the companies in the survey were communicated by webcast. Use of webcasting is especially high in the case of AEX companies (67%) and AMX companies (65%). Little or no use is made of webcasting by local companies.

Language of the general meeting

15% of meetings of shareholders are conducted in English. English is regularly used as the language of communication at general meetings of AEX companies in particular (24%). Where general meetings are conducted in Dutch, a simultaneous translation into English is often available for foreign shareholders and, conversely, for Dutch shareholders if questions are answered in English.

Voting method

72% of the voting items are voted on by acclamation. 76% of AEX companies and 53% of AMX companies issue handheld devices for voting. This rarely occurs in the case of AScX companies and local companies.

Addition of items to the agenda

Under best practice provision 1.2 substantial changes to the corporate governance structure of the company should be dealt with as a separate agenda item. Corporate governance was on the subject of a separate agenda item less frequently in 2007 (27%) than in 2006 (39%). Often the chair of the meeting stated that corporate governance could be discussed in the context of the discussion on the annual report.

The Code provides that various subjects should be separate items on the agenda or should be put on the agenda before a different agenda item. As in 2006 the Monitoring Committee studied the addition of these items to the agenda.

Table 2.4 Agenda items as % of general meetings

Code provision	Subject	2007	2006
I.2	Addition to the agenda of change in corporate governance,	27	39
	of which the following were prior to discharge from liability	58	25
IV.1.4	Separate agenda item for policy on additions to reserves and on dividends	53	59
IV.1.5	Separate agenda item for resolution on declaration of dividend	75	82
IV.1.6	Splitting of discharge from liability for management board and supervisory board	97	98

In its compliance report of 2006 the Monitoring Committee pointed out that items concerning the annual report and corporate governance should be raised before the agenda item concerning the discharge of the management board from liability for its conduct of the company's affairs. This was done by 58% of the companies that dealt with corporate governance as a separate agenda item in 2007. This was more than double the number in 2006.

Best practice provision IV.1.4 provides that the policy of the company on additions to reserves and on dividends should be dealt with as a separate agenda item. This was the case at 53% of all AGMs in 2007, compared with 59% in 2006. The average percentage in the case of AEX companies was 63% in 2007.

In 2007 shareholders exercised the right to add items to the agenda on five occasions in total at the general meetings of shareholders in the survey.

d) Role of the auditor

The external auditor attends and is entitled to address the general meeting of shareholders. Shareholders should in any event have the opportunity to put questions to the auditor about his 'true and fair view' report. This is a consequence of best practice provision V.2.1 of the Code. As in 2006, the survey examined to what extent the external auditor was introduced at the start of general meetings and whether the meetings were informed that questions could be put to the auditor.

The auditor was explicitly introduced at the start of 82% of the meetings held by the companies in the survey. The 2006 figure was 76%. It was expressly stated that questions could be put to the auditor at 47% of general meetings, which was virtually the same as in 2006 but substantially lower than in 2005 (82%).

External auditors responded to a question or comment on 36 occasions in total in 2007. In 13 cases they were responding to a question or comment from the management board or supervisory board. The majority of the questions to the auditor concerned his auditing work, the internal risk management

and control systems, the results and evaluations included in the financial statements and the Sarbanes Oxley legislation.

2.4 Shareholders' questions about the Code

The average number of questions asked at each general meeting in 2007 was marginally lower than in 2006 (35.7 compared with 38.3). 23% of the questions asked during general meetings in 2007 concerned corporate governance (720 questions in total). Most of the corporate governance questions concerned the management board remuneration policy (26%), the remuneration of individual management board members (13%) and the internal risk management and control systems (13%). The high percentage of questions about remuneration may possibly be attributable to the fact that in a relatively high number of cases the provisions of the code on management board remuneration are either not applied (in which case there is an explanation) or not complied with (see chapter 1 above).

42% of the questions about corporate governance related specifically to the Code. This was slightly lower than in 2006 (45%). This decline has occurred mainly in the case of AEX companies (average of 3.8 questions about the Code at each meeting in 2007 compared with 9.7 in 2006). Questions about the Code were asked at the meetings of a larger number and percentage of companies.

2.5 Institutional investors

Principle IV.4 of the Code states that institutional investors (pension funds, insurers, collective investment schemes and asset managers) should act primarily in the interests of the ultimate beneficiaries or investors. Institutional investors have a responsibility to the ultimate beneficiaries to decide, in a careful and transparent way, whether they wish to exercise their rights as shareholder of listed companies.

Chapter IV.4 contains three best practice provisions:

- IV.4.1 provides that institutional investors should publish annually, in any event on their website, their policy on the exercise of the voting rights for shares they hold in listed companies.
- IV.4.2 provides that institutional investors should report annually, on their website and/or in their annual report, on how they have implemented their policy on the exercise of the voting rights in the year under review.
- IV.4.3 requires institutional investors to report at least once a quarter, on their website, on whether and, if so, how they have voted as shareholders in the general meeting of shareholders.

Since 1 January 2007 Dutch institutional investors (in so far as they are pension funds, life insurers and collective investment schemes) are required by law (section 5:86 of the Financial Supervision Act) to comply with chapter IV.4 of the Code in accordance with the 'apply or explain' principle.

Top 5 institutional investors

This year the survey examined compliance with best practice provisions IV 4.1. to IV 4.3 by the five largest institutional investors from the four separate categories (life insurers (LI), collective investment schemes (CIS), company pension funds (CPF) and industry-wide pension funds (IWPF). It is striking that the investors concerned either comply with the Code’s provisions by applying them or do not comply with them. No cases of compliance through explanation of non-application were found. The results are shown in table 2.5.

Table 2.5

		LI	CIS	CPF	IWPF	Total
	general					
	information given about CG	80	100	60	100	85
	no information given about CG	20	0	40	0	15
IV.4.1	*annual publication of voting policy on website*					
	information given	40	100	60	100	75
	no information given	60	0	40	0	25
IV.4.2	*annual publication concerning exercise of voting right*					
	information given	60	80	60	100	75
	no information given	40	20	40	0	25
IV.4.3	*quarterly report on voting behaviour*					
	information given	60	80	60	100	75
	no information given	40	20	40	0	25
	total number of institutional investors	*5*	*5*	*5*	*5*	*20*

Best practice provision IV.4.1 (publication of voting policy on website), best practice provision IV.4.2 (publication of information about exercise of voting policy) and best practice provision IV.4.3 (publication of quarterly report on voting behaviour) are all complied with by 75% of the large institutional investors in the survey.

As far as the top five institutional investors in each category are concerned, the picture is as follows. The five largest collective investment schemes have an average compliance rate of 87%. This compares with only 53% in the case of the five largest life insurers. The compliance rate of the five largest company pension funds is 60%. By contrast, the industry-wide pension funds have a 100% compliance rate.

2.6 Extraordinary meetings of shareholders

Specific attention has been paid this year to extraordinary meetings of shareholders. An extraordinary meeting of shareholders may be convened by a company or, with the leave of the court, by shareholders together holding at least 10% of the issued capital or such smaller amount as may be specified in the articles of association.

In total, 51 extraordinary meetings of shareholders were held in the period from 1 September 2006 to 31 August 2007. This was a substantially higher number than the 22 held in the period from 1 September 2005 to 31 August 2006.

Table 2.6 Most common agenda items at EGMs

	2007	2006
appointment/reappointment of supervisory board member	19	2
appointment/reappointment of management board member	18	7
mergers/acquisitions	18	4
alteration of articles of association	15	4
total number of EGMs	*51*	*22*

Appointments/reappointments of members of the management board or supervisory board and mergers and acquisitions were the most common agenda items during extraordinary meetings.

Shareholders tabled one or more resolutions at three special general meetings. These concerned the following four items:

- a resolution for an alternative strategy;
- a resolution for a strategic reorientation;
- a resolution of no confidence in the supervisory board;
- a resolution for an alteration to the articles of association.

2.7. Promotion of Electronic Means of Communication Act

The Promotion of Electronic Means of Communication Act came into force on 1 January 2007.[6] The purpose of the Act is to promote the use of modern means of communication in the decision-making process of the general meeting of shareholders.

The Act makes it possible for companies to include a provision in their articles of association allowing every shareholder to participate in, address and vote at general meetings via electronic means of communication.

The survey examined how many listed companies altered their articles of association in 2007 solely or partly for the specific purpose of taking advantage of the possibilities provided by the Promotion of Electronic Means of Communication Act. 33 companies were found to have altered their articles of association to take account of the new Act. The breakdown was as follows: 18 AEX companies, 8 AMX companies, 6 AScX companies and 1 local company.

[6] Wet van 20 oktober 2006 tot wijziging van Boek 2 van het Burgerlijk Wetboek ter bevordering van het gebruik van elektronische communicatiemiddelen bij de besluitvorming in rechtspersonen (Stb 2006, nr 525).

2.8 Changes in control structure and issuing of depositary receipts for shares

Changes in control structure

Seven of the companies in the survey reported formal changes to the control structure since 2006. This concerned the following changes:

- two companies have cancelled their priority shares or converted them into ordinary shares;
- two companies have ended the issuing of depositary receipts for shares.
- one company has abolished its dual-board structure.
- one company has converted the special share held by the State into an ordinary share.
- one company has introduced a right under its articles of association for shareholders to call a general meeting of shareholders.

Trust offices

As a result of the issue of depositary receipts, all or part of the shares of 20 of the 89 companies in the survey are held by a trust office (2006: 19 of 83 companies). Two of the 20 companies abolished depositary receipts for shares during their AGM in 2007.

Compliance with best practice provisions IV.2.1 – IV.2.8 by the 16 trust offices that belonged to the survey population in both 2006 and 2007 was analysed by reference to the articles of association, trust conditions and the annual reports of the trust offices.

Table 2.7 Compliance with the Code provisions on trust offices (TO)

Code best practice	Brief description	2007	2006	difference
IV 2.1	Trust conditions determine how depositary receipt holders (DRH) can call a DRH meeting	10	10	0
IV. 2.2.	Trust office board member appointed by trust office board	14	13	+1
IV 2.2	DRH meeting can recommend appointment of trust office board member	13	12	+ 1
IV. 2.2.	dependent persons excluded from appointment	16	14	+ 2
IV. 2.3.	maximum term of office (3 x 4 years)	15	14	+1
IV. 2.4	Trust office board attends AGM	12	12	-
IV. 2.5	Trust office acts primarily in the interests of DRH	11	11	-
IV. 2.6	Presence of trust office report	14	14	-
IV. 2.8	Trust office grants unrestricted voting proxies	13	11	+ 2
IV. 2.8	DRH can issue trust office with binding voting instruction	12	11	+1
	Number of trust offices	*16*	*16*	

The analysis shows that compliance with best practice provisions IV.2.1 – 2.8 has risen slightly. Best practice provision IV.2.7, which consist of many parts, was not included in table 2.7 for practical reasons.

2.9 Conclusions and recommendations

The average attendance rates at general meetings were markedly higher than last year. If the companies that have issued depositary receipts are disregarded, the attendance figure is 50%. The Monitoring Committee is hopeful that the use of electronic means of communication, for which a legal basis has existed since 1 January 2007, will produce a further improvement in attendance rates in the future.

As in 2006 the Monitoring Committee has recommended that in so far as corporate governance items are on the agenda, they should be placed before the item dealing with the discharge of the management board from liability for its conduct of policy. Although the compliance rate has risen in this respect, the Monitoring Committee is still dissatisfied with the extent of compliance with this recommendation across the board.

The Monitoring Committee has this year examined the five largest investors in each institutional investor category. The Monitoring Committee is aware of the limited nature of this survey population. In fact, Dutch institutional investors form only a limited part of the shareholder population of Dutch listed companies.

The picture of compliance by the institutional investors in the survey with best practice provisions IV.4.1 to IV.4.3 is as follows. The five largest collective investment schemes have an average compliance rate of 87%. In the case of the five largest life insurers, this rate is only 53%. The compliance rate of the five largest company pension funds is 60%. By contrast, the industry-wide pension funds have a 100% compliance rate. In fact, the institutional investors concerned either comply with the Code's provisions by applying them or do not comply with them. No cases of compliance through explanation of non-application were found.

The Monitoring Committee would emphasise that compliance with the Code by institutional investors should be 100%%. This is all the more imperative since the compliance duty of Dutch institutional investors has been law since 1 January 2007. If an institutional investor decides not to apply a best practice provision, it must give reasons for this.

Chapter 3. International developments

Below is an overview of developments in the field of corporate governance until December 2007. This overview has been compiled from information provided on the websites of the institutions in question.

European Union

Op 27 February 2007, the European Commission published a report on the implementation of what is known in short as the 'Takeover Directive'. The report showed that many member states have invoked or will invoke the options and exceptions available under the directive to protect companies from hostile takeovers.

On 4 June 2007, the European Commission published a study on the proportionality between ownership and control. The study showed that there is no conclusive evidence of a causal link between deviations from the 'one share, one vote' principle and the economic performance of companies or their directors. The study did find, however, that some investors take a negative view of these deviations and prefer greater transparency in this area to help them take investment decisions.

Op 14 July 2007, the Shareholders' Rights Directive was published.[7] This directive introduces minimum standards that are intended to ensure that shareholders in listed companies receive information on the general meeting in time and are given the opportunity to vote by proxy or by electronic means. It also sets minimum standards for shareholders' rights to ask questions or put items on the agenda of the general meeting. The Directive introduces a minimum notice period of 21 days and a maximum registration period of 30 days for the general meeting. Member States have until 3 August 2009 to transpose the Directive into national laws.

On 19 July 2007, the European Commission published two reports on the application by member states of the recommendations on the remuneration of directors and the independence of non-executive directors or supervisory board members.[8] Both reports show that although the application of corporate governance standards in this area has improved, there is room for further improvement.

On 25 August 2007, the European Corporate Governance Forum published a statement in response to the proportionality study. The Forum calls for greater transparency in relation to the application of non-proportional mechanisms. Companies should be required to provide for a reasoned explanation of the use of these mechanisms, as well as the suitability of these mechanisms for achieving the set objectives. Furthermore, shareholders who have voting rights on the basis of these mechanisms should be required to provide insight into the size and nature of their shareholdings and well as their

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[7] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (EC L 184).

[8] Report on the application by the Member States of the EU of the Commission Recommendation on the role of non-executive or supervisory board members of listed companies and on the committees of the (supervisory) board 13 July 2007, SEC(2007) 1021; Report on the application by Member States of the EU of the European Commission Recommendation on directors' remuneration, 13 July 2007, SEC(2007) 1022, (www.europa.eu/internal_market/company).

policy on the exercise of powers attached to their holdings. These shareholders should also explain what objectives are being pursued by the relevant mechanisms and how they can be justified in view of the interest of the other shareholders. And specific disclosure requirements should be introduced in respect of the use of mechanisms decoupling voting rights from economic ownership, such as securities lending.

On 3 October 2007, Commissioner Charlie McCreevy announced that on the basis of the proportionality study he saw no need for action at the European level. Nor would the European Commission put forward a draft directive on transfers of registered office within the EU.

United Kingdom

In the spring of 2007, the Financial Reporting Council (FRC) held a public consultation on the operation of the Combined Code. As a result of this consultation, the FRC proposed two amendments to the Combined Code on 11 October 2007:

- to remove the restriction on an individual chairing more than one FTSE-100 company (the 'one chair, one company' principle);
- to allow the chair of a smaller listed company to be a member of the audit committee where he or she was considered independent on appointment.

The consultation process on these amendments will start in December 2007.

Op 12 November 2007, the Financial Services Authority (FSA) published a consultation paper on 'Disclosure of Contracts for Difference'. At the moment contracts for differences (CfDs) are used mainly as derivatives of shares which entitle the holder a right to the economic interest in these shares without any disclosure requirements for these derivatives.[9] The FSA has concluded that CfDs are not used systematically as alternatives to shares, but that there are situations in which CfDs are used to exercise influence in the company in question on an undisclosed basis. The FSA is consulting on two options:

1) to require disclosure of economic interests above a certain threshold, unless the holder of that interest has taken measures not to exercise influence over the underlying shares;
2) to require all holders of an economic interest in a company of 5% or more to disclose this fact.

The consultation period will end on 12 February 2008.

Germany

On 14 June 2007, the Regierungskommission Deutscher Corporate Governance Kodex adopted changes to the German corporate governance code. The main changes are:

- the restriction of the severance pay for directors to two years;

[9] The mirror image of CfDs is a shareholder who has legal title to but no economic interest in the shares, which may influence how the shareholder exercises the voting rights. The Monitoring Committee made a recommendation to the government on this issue in May 2007; see the recommendations on 'empty voting / securities lending'.

- the formation of an appointment committee from supervisory board members, but only from shareholders' representatives; the appointment committee will propose candidates to the supervisory board for appointment by the general meeting.

Under section 161 of the Aktiengesetz (Shares Act), the management boards and supervisory boards of listed companies are required to state annually that the Kodex is being applied. Alternatively, they must explain which recommendations have not been applied, and why.

On 24 October 2007, the German government published a bill aimed at containing the risks associated with financial investments (Gesetz zür Begrenzung der mit Finanzinvestitionen verbundenen Risiken). The bill includes the following provisions:

- a more detailed definition of the concept of 'acting in concert';
- a requirement on one or more shareholders representing more than 10% of the voting rights to notify the company of their intentions and the source of their financial means;
- further measures on the identification of shareholders;
- tighter legal sanctions (namely a 6-month voting ban) for non-compliance with the various notification requirements.

Belgium

On 1 October the 2007, the Belgian Commission on Corporate Governance published a consultation paper on the country's Corporate Governance Code ('Lippens Code'). The Lippens Commission wants to examine to what extent the Lippens Code contributes adequately to the development of governance practices promoting entrepreneurship and risk management. The Commission is interested in particular in receiving opinions and suggestions on the Lippens Code's effectiveness (i.e. contribution to improved governance and value creation over the long term), its structure and reach (such as questions on Code's transparency and comprehensiveness), the approach on the basis of the 'apply or explain' principle (i.e. the Code's flexibility and supervision of compliance), and, finally, the announcement of the Code's provisions. The responses will provide the basis for any amendments to the Lippens Code and for proposals for a more efficient application of its provisions. The consultation period ended on 30 November 2007.

United States

Op 27 August 2007, the Securities and Exchange Commission (SEC) revised its rules regarding the management report on internal risk management within the framework of financial reporting (ICFR) in order to show that one of the ways in which the required evaluation of the ICFR's effectiveness can take place is through an evaluation which complies with the SEC's interpretative guidance published in No. 34-55929. It also provides a definition of 'material weakness': 'a deficiency, or a combination of deficiencies, in ICFR such as that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis'. The requirements on the auditor's report with regard to the ICFR's effectiveness have also been

revised. The changes are intended to facilitate more effective and more efficient evaluations of the ICFR by directors, accountants and auditors.

Op 28 November 2007, the SEC announced changes to its rules aimed at stimulating the use of electronic shareholder forums. On the same day the SEC also adopted a change aimed at clarifying the grounds on which companies can refuse to send information to and from shareholders. Specifically, companies may refuse to send out proposals by shareholders on the nomination or election of company directors or the associated procedures.

On 30 November 2006, the Committee on Market Regulation, an independent and impartial group of leading members of the investor community, business, finance, law, accounting and academia, published an interim report. The Committee recommends changes in capital market regulation based on the twin goals of enhancing shareholders' rights while reducing excessive and overly burdensome regulation and litigation. As of December 2007, this report has not been acted on.

Australia

On 2 August 2007, the ASX Corporate Governance Council published the revised Corporate Governance Principles and Recommendations. The key changes are as follows:

- 'best practice' has been removed from the title and the text of the document in order to eliminate any perception that the Principles are prescriptive, and so not to discourage companies from adopting alternative practices and 'if not, why not' reporting where appropriate;
- the 'independence' of members of the board of directors is no longer defined; instead the document sets out a list of relationships which may affect the independent status; companies are required to disclose their reasons for considering a director 'independent' despite the existence of one of these relationships;
- companies' trading policies should prohibit hedging unvested options, and companies should disclose their policies on hedging vested options;
- 'material business risks' involve both financial and non-financial risks, including risks relating to corporate social responsibility and sustainability; companies are encouraged to adopt appropriate risk oversight, management policies and internal risk management systems rather than disclosing specific material business risks;
- 'assurance' with regard to financial reporting has been revised: the board of directors is required to disclose that it has received assurance from the CEO/CFO that the declaration under section 295A of the Corporations Act is founded on a sound system of risk management and internal control which is operating effectively in all material respects in relation to financial reporting risks.

The revised Principles become effective for the first financial year commencing on or after 1 January 2008.

Part 2 – Specific issues

Chapter 4. Internal risk management and control systems

Introduction

The Monitoring Committee notes that compliance with and application of the provisions on internal risk management was slightly better in the 2006 than the 2005 financial year. Nonetheless, the Committee would make a number of observations about risk reporting in the annual report. The Monitoring Committee believes that the description of the strategic, operational and financial risks as well as the legislative and regulatory risks can be improved and that these risks, including the financial reporting risks, should be qualified and quantified. The Committee therefore makes a number of recommendations for describing the risk profile and the internal risk management and control system.

Risk management and the distinction between the different risk categories

The Monitoring Committee would point out that risk management should form an integral part of the company's business operations. This is about how the company manages its strategic, operational, financial, compliance and financial reporting risks. It should be emphasised here that financial risks are not the same as financial reporting risks. The risk management process should be described in the annual report. This risk report should contain the description of the corporate risk profile, an explanation of the internal risk management and control system that is in place and an 'in control' statement.

In its report published in December 2005 the Monitoring Committee made a distinction between the financial reporting risks on the one hand and the strategic and operational risks and legislative and regulatory risks on the other (classed as 'other risks'). Whereas a description of the risk profile and internal risk management and control system is required for all risk categories, the need for an 'in control' statement is confined to the financial reporting risks. Differentiation by risk type is considered desirable in the light of internationally accepted best practices and prevailing opinions on the practical implementation of the 'in control' statement. Moreover, it is difficult to issue an 'in control' statement about risks that do not result from the financial reporting, partly in view of the possible legal consequences (i.e. increased liability risks). However, this difference in treatment does not reflect a difference in relevance. The consequences for a company of strategic and operational risks, financial risks and legislative and regulatory risks can be at least as great as the risks resulting from the financial reporting.

Given the importance of strategic, operational and financial risks as well as legislative and regulatory risks, the Monitoring Committee notes that in practice there is room for improving the descriptions (of the risk profile and the internal risk management and control system for these risks). Last year the Monitoring Committee urged companies to pay greater attention to quantifying the consequences of identified risk factors where these risks occur. The Monitoring Committee realises that the extent to which risks can be quantified depends in part on the nature of the sector. It welcomes market-based

initiatives aimed at defining and improving the process of risk management.[10] An improved definition of the process can serve as a checklist for the management board and supervisory board. Naturally, however, this should not result in the adoption of a standardised format for the risk section in annual reports.

The Monitoring Committee considers it worthwhile formulating recommendations for the description of the risk profile and the internal risk management and control system in addition to the previous guidance given in respect of the 'in control' statement. These recommendations relate to all kinds of risks affecting the company. Priority should be given here to the interests of readers of the annual report. The content of the risk report should meet the information needs of shareholders and other stakeholders.

Description of the risk profile

First of all, the company should outline in its risk report what risks it encounters or may encounter in implementing its strategy. This should be done in the description of the corporate risk profile outlining the main risks faced by the company. The company should also state what risks it is prepared to take in order to achieve its objective and if possible quantify them by means of a sensitivity analysis. This will allow readers of the annual report to decide whether they share the company's attitude to risk. The risk profile should in any event cover the following points:

- the main risks related to the company's strategic objectives and its appetite for risks;
- a description of the main strategic, operational, financial, legislative/regulatory and financial reporting risks of the company, including in any event the qualitative impact of these risks, possibly supplemented by a description of how the company deals with these risks;
- a sensitivity analysis of the identified risks if it is reasonable to expect such an analysis in the light of the best practices in the sector concerned.

Description of the internal risk management and control system

Besides describing the risk profile, the company should explain how the internal risk management and control system is structured and how it is tailored to the risk profile. This should indicate what measures the company has taken to control the identified risks. It should deal not only with the system itself but also with how it is embedded in the organisation. It is recommended that the following points be discussed:

- the risks which are managed by the internal risk management and control system and, if necessary, the reference model used to configure the system;
- the organisation of the internal risk management and control system and how it is embedded in the organisation; the division of responsibilities and the planning, monitoring and evaluation;
- the results of a periodic evaluation of the structure and operation of the internal risk management and control system and, in so far as applicable, the improvement measures taken as a result.

[10] Evaluation of 2007 AGM period, June 2007 (www.eumedion.nl) and the NIVRA discussion paper, October 2007 (www.nivra.nl).

The report on the internal risk management and control system should be seen in conjunction with best practice provision III.1.8. This states that the supervisory board must discuss at least once a year the corporate strategy and the risks of the business, and the result of the assessment by the management board of the structure and operation of the internal risk management and control systems, as well as any significant changes thereto. Reference to these discussions should be made in the report of the supervisory board. The results of this discussion should also be reflected in the report on the risk management and control system.

Place of description of internal risk management and control systems

The Monitoring Committee notes that 90 of the 122 companies deal with the internal risk management and control systems in a separate part of the management board report or the annual report. The Monitoring Committee would emphasise once again the desirability of dealing with the internal risk management and control system as far as possible in one place.

Reference model

The Monitoring Committee notes that COSO Integrated Internal Control Framework (COSO-I) is the reference model most frequently mentioned. Most companies, particularly local companies, do not refer to a reference model. The Monitoring Committee considers that a reference model can be useful in classifying the risk management and control systems, but acknowledges that it is not necessary to refer to a model if the risk management is clear to the company.

Chapter 5. Relationship between remuneration of management board members and corporate performance

5.1 Introduction

The remuneration of management board members of listed companies is currently attracting a great deal of public interest. The level of remuneration of management board members and the relationship between performance and remuneration have this year again given rise to a heated public debate. This has been due to a number of noteworthy individual cases.

As well as being a public issue, the remuneration of management board members is also an aspect of corporate governance. The Dutch Corporate Governance Code contains a number of principles and best practice provisions in this regard. This was one reason why the Corporate Governance Monitoring Committee, partly at the request of the government, devoted extensive attention to this topic in its 2005 and 2006 annual reports. The Monitoring Committee made a number of recommendations in those reports aimed at improving the process and structure of management board remuneration. It recommended, for example, that the supervisory board should play a leading role here, and also that there should be a clear relationship between the remuneration of management board members and the performance of the companies under their management.

In its 2006 annual report, the Monitoring Committee observed that little was known about the actual relationship between corporate performance and the remuneration of management board members. The Monitoring Committee accordingly commissioned a study of the remuneration of management board members and the relationship between their remuneration and corporate performance over the period 2002-2006. This chapter presents the results of that study and, partly on the basis of those results, puts forward a number of recommendations for the process and structure of management board remuneration.

Section 5.2 discusses the study approach. Section 5.3 looks at the theoretical factors that influence management board remuneration; section 5.4 discusses how the remuneration of management board members in the Netherlands compares with the situation in other countries; section 5.5 describes the actual level of remuneration and the performance criteria used; section 5.6 explores the relationship between remuneration and corporate performance; section 5.7 looks at severance pay; finally, section 5.8 presents a number of conclusions and recommendations.

5.2 Study approach

The Monitoring Committee commissioned a study of Dutch listed companies by the University of Groningen and Towers Perrin to ascertain the level of management board remuneration and the relationship between this remuneration and corporate performance between 2002 and 2006. The remuneration of management board members of unlisted companies (including private equity firms) and the remuneration of management board members in the public sector were excluded from the study.

The purpose of the study was to provide reliable and clear information on the trend in the income of management board members in the Netherlands, and more particularly on the relationship between that income trend and the performance and value development of the companies under their management. The study was therefore not concerned with the relationship between remuneration and the performance of individual management board members.

The remuneration of management board members generally consists of a fixed component (basic salary) and a variable component. The variable component is in turn generally broken down into a short-term and a long-term portion. The fixed remuneration component is determined using benchmarking based on a reference group of companies and internal remuneration ratios. The short-term variable component is often based on a combination of financial performance criteria and personal and qualitative targets. The level of the short-term variable remuneration is generally derived from the fixed annual salary. The long-term component generally takes the form of option and/or share schemes and is almost always linked to predetermined performance targets, which may or may not be linked to the performance of the company.

In summary, the following questions were studied:

- How is the remuneration of management board members of Dutch listed companies structured, which arguments form the basis for the remuneration and to what extent can this structure be justified using scientific insights into management board remuneration?
- What are the main developments in the remuneration of management board members of Dutch listed companies, partly in the light of international developments in this regard?
- What criteria are applied in determining the various remuneration components, and what developments have occurred in the various remuneration components?
- Is there a statistically significant (and substantial) correlation between the four most widely used business performance variables (sales, profitability, earnings per share and relative shareholder value creation) and the actual level of and changes in the various components of management board remuneration?
- What is the relationship between the level of severance pay and the justification of this level?

In order to answer these questions, detailed qualitative and quantitative information was gathered on management board remuneration at 107 listed Dutch companies, the performance of those companies, the targets set for management board members and the remuneration policy of the companies concerned (sections 5.5 and 5.6). The survey included virtually all AEX, AMX and AScX companies plus a relevant selection of local companies. The international comparison (section 5.4) is based on a relevant selection of European countries and the United States, with between 25 and 50 of the leading companies in each country being included in the study. Where possible, a distinction was made in the study between the remuneration of the chairman of the management board and the other board members. The complete study may be consulted on the Monitoring Committee's website at www.commissiecorporategovernance.nl.

5.3 Theory

This section looks at the theoretical and practical factors which play a role in the level and structure of management board remuneration.

General picture

The employment market for senior management board members has its own specific dynamic. Since demand (companies) and supply (management board members) are relatively inelastic in this market - in other words, the demand will change little if the level of remuneration changes - small shifts can result in large market-driven jumps in remuneration. Thus, for example, the remuneration of management board members is likely to rise significantly where their risks or responsibilities increase (for example if the company is in financial difficulties), or if they could find employment elsewhere (for example in private equity-led companies).

Since remuneration is based on individual negotiations, in an imperfect market the level of remuneration can rise even without any noticeable shift in supply or demand. The increase is then constrained by the risk of objections by the company's stakeholders. At present, there is no uniform yardstick to assess the outcome of the negotiation process with a prospective board member (in this case the ex ante level of remuneration). This makes the structure of the contract and the process all the more important. The remuneration committee plays a central role here.

The strong negotiating position of management board members referred to above can also result from an excessive dependence on one candidate. For this reason it is very important that the supervisory board (in particular the selection committee) supervises the succession planning and talent management. The outcome of this process should be taken into account when assessing incumbent management board members. The availability of potential successors, both for the position of chairman and for the other positions on the management board, is an important criterion when assessing incumbent management board members.

Structure of remuneration contracts

Two moments are of importance for the variable performance-related pay component: the moment at which the pay component is proposed (ex ante remuneration), and the moment at which it is actually paid (ex post remuneration). At the first moment, the expected level of the variable pay component is determined; this may be higher or lower at the second moment, depending on the performance to be delivered. In addition to the expected performance, the structure of the contract is also important for the ex post remuneration.

An adequate contract structure is important for attracting the right management board member. This will make it more likely that a candidate with the desired profile becomes available and that candidates with the wrong profile pull out. For example, a contract with a higher risk element will attract a different

kind of management board member, appealing to candidates who expect to deliver a very strong performance based on a combination of their own abilities and the potential of the company. An individual with greater risk aversion will be more inclined to choose a company which offers a more stable remuneration regime (lower ‘pay for performance’ ratio).

The factors to be considered when designing a performance contract include the criteria, targets and mix of pay components needed to achieve an optimum result. The literature provides relatively little in the way of rules that can be applied to every company in every situation, and shows that individual choices have to be made based on the specific case in hand in order to arrive at an optimum contract design. This makes the task of the remuneration committee more difficult (also because a number of parameters, such as aversion to risk and effort are difficult to quantify). Following the market practice or applying certain recommendations can be helpful for the formation of ideas, but does not relieve the remuneration committee of its task of making the right decision in the specific circumstances of the case.

When designing the remuneration contract, the remuneration committee has to take a great many decisions and reconcile a number of different perspectives. In certain circumstances a miscalculation can lead to undesirable situations:

- use of an incorrect performance criterion can lead to an incorrect focus on the part of the management board member;
- use of overly ambitious targets can demotivate management board members;
- targets which are too easily achieved may not be easy to reconcile with the principle of pay for performance;
- simple plans are often easier to justify to shareholders and the outside world, but may ignore the complexity of creating and measuring the right incentives.
- reporting on the long-term remuneration can take place in several ways: for example, IFRS 2 allows scope for different ways of valuing share-based remuneration.

Role of the remuneration committee in the process

The remuneration committee is important not only in drafting the structure of the remuneration contract, but also in the process of remunerating management board members. Given that the situation is not one in which individuals act entirely rationally, that the context is important and that there may be also be coalition formation, the key to a better understanding of management board remuneration appears to lie more in the process than in the result.

The remuneration and appointment committee often uses a frame of reference in the negotiating process which has both external and internal aspects. The internal reference is often the other management board members and the second echelon of management. Another internal aspect is the

reputation of the supervisory board members in the general meeting of shareholders. The external reference is often a labour market reference group (peer group).

The foregoing makes clear the crucial importance of a properly constituted and functioning remuneration committee. The remuneration committee has the best chance of negotiating a remuneration contract successfully if its members have a sufficient knowledge of the company's organisation and of the remuneration instruments and if the committee is independent of the management board. With sufficient knowledge of the organisation and its processes, a remuneration committee can determine adequate performance criteria and targets. Sufficient knowledge of the remuneration instruments can enable a remuneration committee to avoid awarding incorrect, excessive or inadequate pay components.

5.4 International context

This section discusses how management board remuneration in the Netherlands compares with that in other European countries and the United States.

General picture

International comparative study shows that the remuneration of management board members in Europe has risen in recent years and is now closer to that of American board members (though the latter still earn considerably more than their European counterparts). The Netherlands is not a trend-setter in this respect: broadly speaking, the rises in neighbouring countries have been greater. The Netherlands is in line with other European countries on many remuneration components; only Sweden has a different pattern due to its relatively low variable pay component. There are, however, differences of emphasis between countries. For example, Germany is known for its relatively high (short-term) bonuses, and France for its relatively high long-term remuneration components. The Netherlands occupies an intermediate position on these aspects. The picture in the United States differs fundamentally from that in Europe; neither the remuneration level nor the mix is comparable with the European situation. Management board members in the US, and especially board chairmen, earn significantly more than their European counterparts, and their total direct remuneration has a bigger variable component.

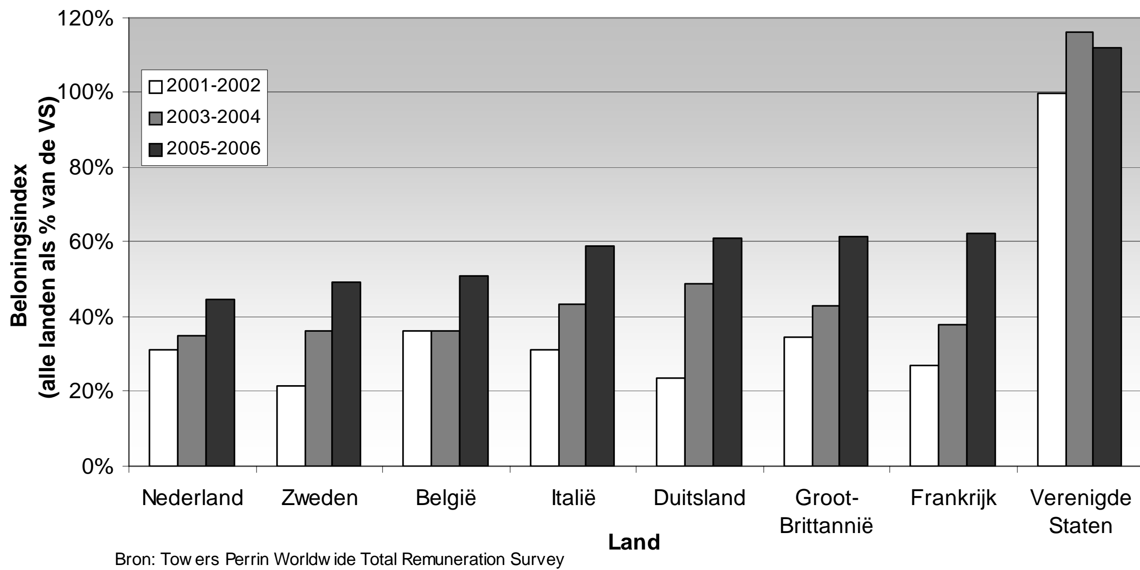
The degree to which international trends are followed depends partly on the peer group chosen. For Dutch AEX companies, the peer group used is both international and sector-specific. Dutch companies differ in this regard from the general pattern of companies in other countries studied, which maintain a more domestic focus.

The position of the management board chairman relative to the other board members varies from country to country. The difference in remuneration between the chairman and members is smallest in Germany and the Netherlands, while the United States and France score highest on the CEO model. These results are influenced by the fact that in one-tier board companies the remuneration paid to non-executive board members is included.

Total remuneration

Figure 5.1 compares the remuneration of chairmen of companies of comparable size (sales of USD 500 million) from a number of relevant countries, expressed as a percentage of the situation in the United States.

Figure 5.1



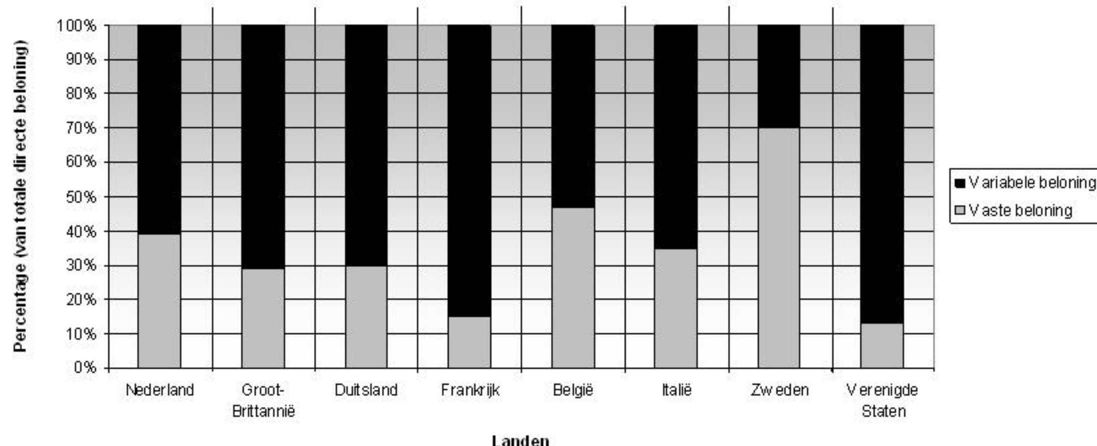
Pay has risen in Europe in recent years. Although the total remuneration of European management board chairmen is now closer to that of their American counterparts, the latter still earn considerably more. The Netherlands is not an international leader here and comes nearer to the bottom than the top of the bandwidth in terms of remuneration level. Moreover, remuneration levels have increased faster in neighbouring countries in recent years.

Nor is the Netherlands a leader when it comes to a comparison of general pay levels in the various countries, for example expressed as the pay differential between a management board member and a factory worker. In relative terms, the Netherlands has fallen from a top three position to bottom position between the first measurement (2001/2002) and the most recent measurement (2005/2006), which means that the pay gap between a typical management board chairman and a typical factory worker is smallest in the Netherlands - although it is reasonably comparable to the position in Sweden and Belgium. In all these countries, a management board chairman earns approximately 20 times as much as a factory worker; in the United Kingdom it is nearer 30 times as much and in the United States 40 times as much.

The variable pay component has grown over the last ten years in Europe. This has not taken place at the expense of the fixed remuneration, so that the total direct remuneration has risen. The proportion of fixed to variable pay has moved in favour of variable pay; Sweden forms an exception to this trend.

Figure 5.2 shows the relationship between the fixed and variable portion of the remuneration of the chairmen of the management boards of the biggest listed companies.

Figure 5.2



Dutch management board chairmen occupy third place after Belgium and Sweden for the highest percentage of fixed pay (in the Netherlands the fixed/variable proportion averages 40/60). The United States and France have the highest percentage of variable pay (approx. 15/85). It can be concluded from this that, although variable pay has gained in importance in the Netherlands, the variable pay component of management board chairmen is still relatively smaller than in other European countries. The picture is more or less the same for the other management board members, though the differences are less pronounced (45/55 for the Netherlands).

Performance criteria used

If we look at the performance criteria for short-term remuneration in different European countries and the United States, the following picture emerges:

Table 5.3

Top 5 performance criteria within short-term remuneration

	Netherlands	Europe (UK, Ger, Fra, Bel, Ita, Swe)	United States
1	Operating profit	Operating profit	Revenue
2	Revenue	Revenue	Earnings per share
3	Economic profit (EVA)	Earnings per share	Operating profit
4	Cash flow	Return on invested capital	Net income
5	Net income	Net income	Cash flow

The criteria used in the Netherlands (which are discussed in more detail in sections 5.5 and 5.6) largely correspond with those used in other countries, though there are differences in the way they are applied. In both Germany and the Unietd Kingdom, 'the bottom line' is the most common method of measuring performance. Net income is used for this in Germany, while earnings per share is not used at all within bonus plans. The reverse applies in the UK.

The picture for the most commonly used *long-term* criteria is as follows.

Table 5.4

Top 2 performance criteria within the long-term remuneration

Country	1	2
Netherlands	Relative shareholder value	Earnings per share
United Kingdom (shares)	Relative shareholder value	Earnings per share
United Kingdom (options)	Earnings per share	Relative shareholder value
Germany	Share price appreciation (absolute and relative)	Economic/operating profit
France	Absolute and relative shareholder value, revenue, operating profit, net income	
Belgium	n/a	n/a
Italy	Operating profit	Relative shareholder value, earnings per share
Sweden	Economic profit (EVA)	Earnings per share
United States	Earnings per share	Absolute shareholder value

Relative shareholder value is the main criterion in countries such as the Netherlands, the United Kingdom and France. In other countries, such as Italy (operating profit) and the United States (earnings per share), profit is more important.

<u>Annual bonus (short-term remuneration)</u>

Figure 5.5, which shows the annual bonuses of the chairmen of companies of comparable size (revenue of USD 500 million) relative to the lower and upper end of the market, shows that annual bonuses rose sharply in the period 1996-2005.

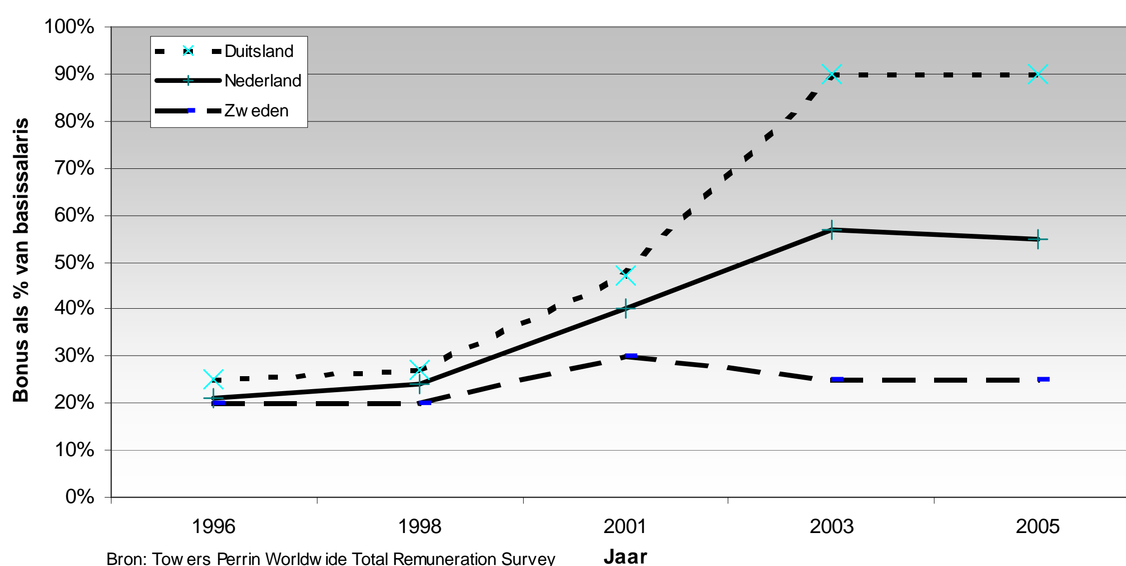


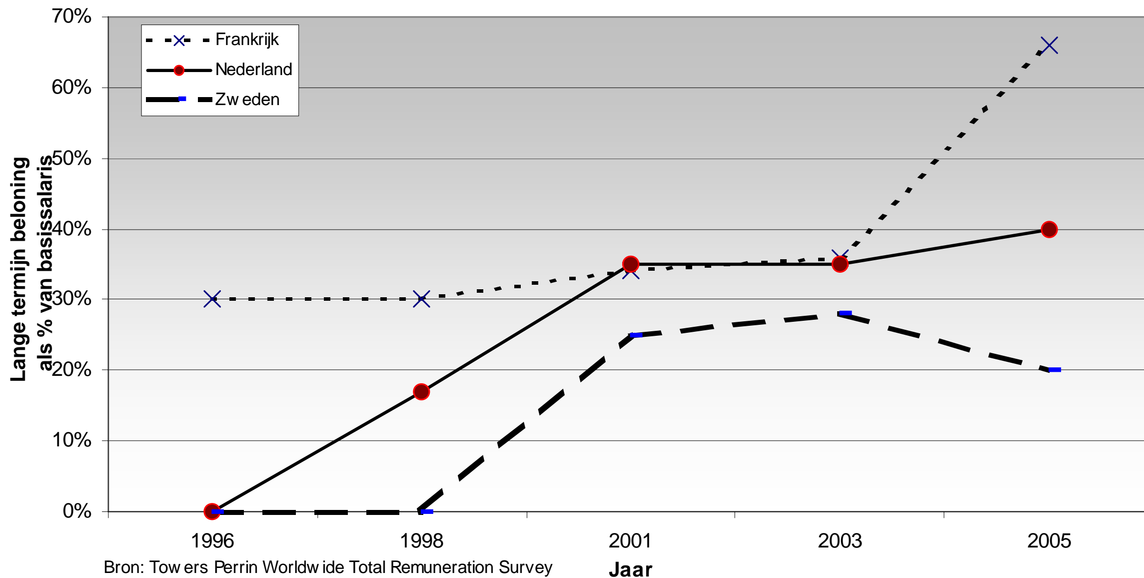
Figure 5.5

The most extreme growth in bonuses as a proportion of basic salary appears to have passed, however. The highest annual bonuses were paid in Germany, the lowest in Sweden; the Netherlands occupies an intermediate position.

Shares/options (long-term remuneration)

Figure 5.6 gives an impression of the trend in the long-term remuneration of chairmen of the management boards of companies of comparable size (sales of USD 500 million) relative to the upper and lower end of the market.

Figure 5.6



In 1996, the use of long-term remuneration (such as options and/or shares) was virtually unknown in Dutch companies; by 2005, however, this form of remuneration had grown to 40% of basic salary. France represents the upper end of the market, with the highest long-term remuneration component in percentage terms. Long-term remuneration is lowest in Sweden. Naturally, this only applies to companies that use a long-term remuneration component; roughly a third of Dutch listed companies do not use share or option schemes at all (see section 5.5).

5.5. Remuneration levels and criteria

This section explores the actual trend in management board remuneration at Dutch listed companies which were listed for at least three years between 2002 and 2006. They are divided into three clusters: AEX companies, midcap companies and local companies.[11]

In addition to fixed salary, virtually all management board members of Dutch listed companies receive a variable, performance-related salary component. This performance-related component is generally further broken down into two parts: a cash bonus for the short term (performance over the past year) and a long-term bonus, which is usually paid out in the form of options and/or shares. The time horizon for the long-term performance bonus is generally three years.

Fixed salary

Table 5.7 shows the median of fixed salaries in the period 2002-2006 in the three categories of companies.

Table 5.7

Median fixed salary (x €1)										
	2002		2003		2004		2005		2006	
	n	€	n	€	n	€	n	€	N	€
AEX companies										
Chairman	25	623,100	28	729,500	28	776,000	23	803,000	22	813,500
Management board members	92	529,750	90	520,858	88	531,250	78	528,500	87	575,000
Midcap companies										
Chairman	30	383,500	29	422,000	29	428,000	30	442,000	31	490,800
Management board members	63	310,000	61	313,000	65	309,000	60	337,841	70	347,833
Local companies										
Chairman	56	226,945	60	239,391	60	257,000	59	264,000	59	280,500
Management board members	79	222,546	71	211,916	66	213,000	65	268,000	71	240,000

Fixed salaries increased over the period 2002-2006. The fixed salaries of chairmen increased more than those of other management board members, and rose most of all for chairmen of AEX companies. The table also shows that the remuneration of other management board members at AEX companies and midcap companies is roughly 75% of the basic salary of the chairman. Since the basic salary of a chairman has grown faster than that of the other management board members, a steeper income distribution arises in later study years between the chairman and other management board members.

[11] The report by the University of Groningen divides AEX companies into two clusters (making a total of four clusters). For the sake of clarity, the Monitoring Committee has opted to treat the AEX as a single entity, as is also done in the summary (section 4.8) of the study by the University of Groningen.

Annual bonus

Table 5.8 shows the trend in annual cash bonuses paid. These bonuses have not been adjusted for management board members whose term of office began or ended during the financial year in question.

Table 5.8

Median annual bonus paid (x €1)										
	2002		2003		2004		2005		2006	
	n	€	n	€	n	€	n	€	n	€
AEX companies										
Chairman	25	305,932	28	331,450	28	623,250	23	588,000	22	892,750
Management board members	92	186,821	90	192,379	88	302,400	78	330,740	87	427,000
Midcap companies										
Chairman	30	115,997	29	125,000	29	156,778	30	200,125	32	226,000
Management board members	63	35,000	61	50,000	65	75,000	60	131,000	70	102,321
Local companies										
Chairman	60	25,000	61	37,000	61	53,500	59	83,000	59	88,020
Management board members	81	0	73	50,000	68	45,558	68	63,009	75	67,312

It can be seen that annual bonuses grew rapidly across the board in the period 2002-2006. It is striking that the bonuses paid to chairmen of AEX companies were substantially lower in 2005 than in 2004. The difference between the bonuses paid to chairmen and to other management board members is also striking; in most cases, the bonuses paid to management board members were 40-60% of the bonuses paid to the chairman. Local companies form an exception to this rule; here, the differences are smaller.

One-off and other cash payments

This pay component can be divided into occasional and other cash payments. Occasional payments include payments made when a management board member takes office, or payments for one-off achievements such as the successful integration of a newly acquired business unit. Other regular remuneration includes the use of company assets by a management board member. There is wide variation in these payments. Social insurance and supplementary pension contributions often fall into this category (although some companies report these as part of the fixed salary). This category of payments also includes signing-on bonuses, relocation expenses, compensation for tax on long-term plans and the provision of company cars.

Occasional and one-off payments are paid only by AEX companies. The median payment varies widely from one year to another. In individual cases, the remuneration can be greatly influenced by these payments.

Option schemes

For some companies, options and shares constitute a substantial remuneration component. An average of 38% of companies use or have used these remuneration components on a more or less structural basis.

The study distinguished between conditional, unconditional and freely marketable (i.e. immediately exercisable) options). In the Code, conditional options are options whereby management board members are required to achieve predetermined performance criteria within a period of at least three years following the granting of the options. Options granted after a performance has been delivered and which can then be exercised - following a certain waiting period based on the Code - are unconditional options. Options which were granted in the year of the study and which can be exercised without observing a waiting period are freely exercisable options.

68 of the 107 companies studied operated option schemes as a remuneration component in any one year covered by the study. It was found that option schemes are used more by large companies than by small companies. The majority of local companies do not have option schemes. A slight fall in the number of unconditional options granted can also be observed, except at local companies. The number of directly exercisable option schemes (no waiting period) has fallen, especially at midcap and local companies.

Share schemes

42 of the 107 companies studied include share schemes as part of their remuneration packages. Prior to 2005, only AEX companies operated share schemes for their management board members, and these constituted a relatively small proportion of total remuneration. After 2005 the popularity of share schemes increased, partly at the expense of option schemes.

Actual performance criteria

To obtain a picture of the performance criteria applied by Dutch listed companies, the study looked at the actual performance criteria as set out in the annual reports for 2005 and 2006.[12] Dutch listed companies apply a wide variety of performance criteria for the variable remuneration component, and often apply combinations of criteria. Companies reported more performance criteria in 2006 than in 2005. The criteria are sometimes formulated fairly generally, possibly with a reference to the sensitive nature of the information. The emphasis for both the short and long-term remuneration is on financial criteria; qualitative criteria are used relatively little.

A total of 72 short-term performance criteria are applied. The most frequently used financial performance criteria in 2006 were EBIT(D)A/Operating Profit (20), revenue (13), earnings per share (12) and free cash flow (9). The most commonly used qualitative performance criteria in 2006 were personal targets (6) and market share (2). The short-term performance criteria are concerned mainly

[12] In addition, the discretionary portion of the short-term bonus is determined by the supervisory board on the basis of considerations which are not always specified (in advance).

with the performance of the company (and the management board members) in an absolute sense. The financial performance criteria are focused chiefly on the (financial) results of the company, while the qualitative performance criteria are focused more on the specific (strategic) activities of management board members.

The short-term performance criteria can be clustered as follows.

- Revenue
- EBIT(D)(A) / Operating Profit
- Net income
- Earnings Per Share
- Economic Value Added / Economic Profit
- Cash Flow
- Cost
- Total Shareholder Return
- Other financial performance criteria: Return on Invested Capital, Return on Capital Employed, Working Capital, Profit before Taxes, Gross Margin, etc.
- Customer satisfaction
- Employee satisfaction
- Market share
- Corporate social responsibility/sustainable development

The *long-term* performance criteria are more focused on the performance of the company relative to comparable companies and are predominantly concerned with the creation of long-term shareholder value. The most widely used financial criteria in 2006 were relative *Total Shareholder Return* (35), *earnings per share* (8) and *EBIT/Operating profit* (6). The most frequently used long-term qualitative criterion in 2006 was a personal target (3). Other examples of qualitative criteria are strategic goals, product development, risk control, knowledge management and successful conclusion of an agreement with a partner.

The choice of short-term performance criteria appears to be focused on the scope for influence (by the management board member), while the long-term criteria appear to be concerned more with the dimension 'goal achievement' (by the organisation), i.e. the creation of shareholder value.

Total remuneration

For the purpose of this study, total remuneration is defined as the change in the assets of the management board member in so far as this relates to payments made by the company or a right to shares in the company or derivatives of such shares. Total remuneration can be divided into two components: the change in the value of (charged) assets granted to the management board member at the start of the financial year, with or without conditions, and cash payments and assets granted during the course of the year. The value of directly exercisable shares and options held at the start of

the financial year does not form part of the remuneration. Payments towards pension accrual are left out of consideration because these are virtually uninfluenced by the corporate performance and because of the wide variation in reporting on pensions by the different companies and across the different years.

Table 5.10

Median total remuneration (x €1)										
	2002		2003		2004		2005		2006	
	N	€	n	€	N	€	n	€	n	€
AEX companies										
Chairman	25	1,283,463	28	1,567,972	28	1,912,448	23	3,257,276	22	3,279,873
Other board members	92	842,359	90	1,104,095	88	1,272,500	78	1,992,834	87	1,684,097
Midcap companies										
Chairman	30	536,477	29	658,689	29	804,141	30	951,560	31	778,620
Other board members	63	411,112	61	530,463	65	503,924	60	681,558	70	601,675
Local companies										
Chairman	56	300,071	60	340,050	60	356,178	59	407,000	59	411,259
Other board members	79	276,400	71	294,000	66	319,447	65	379,000	71	404,975

All management board members saw their total remuneration increase in the period 2002-2006. The total remuneration is higher at large companies, where it has also increased faster than at smaller companies. The remuneration of the chairman rises more quickly than that of the other board members. An important element in the increase in total remuneration is the rise in value of the (usually conditional) share allocations. The ultimate (unconditional) share allocation and the movements in the price of the shares can influence the outcome.

5.6 Relationship between remuneration and corporate performance

As described in the previous section, there is great variation in the number of performance criteria used. This section looks at the results of the study of the relationship between management board remuneration and corporate performance. A distinction is drawn between chairmen and other management board members. A distinction is also made according to the level of and growth in remuneration. This is because performance can have a direct influence on the level of remuneration, but can also leader to faster or slower growth in the remuneration depending on the performance of the company.

The relationship between management board remuneration and corporate performance was studied using the following four performance criteria:

- Net sales;
- Profitability;
- Earnings per share;
- Relative shareholder return, measured as the deviation from the average shareholder return in the cluster.[13] Shareholder return is equal to the share price gains plus dividend received during a year, divided by the share price at the start of the year.

These four criteria represent around 56% of the short-term performance criteria and 80% of the long-term criteria used. The number of employees was included as a control variable.

The study of the four criteria was constrained by three limitations:

- The study looked at relationships between remuneration and four separate performance criteria. Combinations of different criteria in a single remuneration package - as often happens in practice - were not included.
- The study focused only on the question of whether performance influences remuneration. The question as to the reverse relationship, namely the influence of remuneration on performance, cannot be answered on the basis of this study.
- It is unclear how much time elapses between performance and remuneration. In the study, evidence was found for both simultaneous effects and for the effects of performance on remuneration in the following year.

Fixed salary

The fixed salary is generally not related to performance criteria. It appears to increase at a constant rate and not to be dependent on corporate performance. The number of employees does, however, appear to have a positive impact for board chairmen. Higher net sales lead to a relatively lower fixed salary for board chairmen; this may mean that larger companies have more variable forms of

[13] The reference group thus consists of companies of equal size. This is a different reference group from that generally applied by the companies themselves.

remuneration (sales are, after all, also a measure). Earnings per share has a negative effect on the fixed salary of other management board members.

Bonuses (short-term remuneration)

Bonuses appear to track immediate performance; a positive correlation is generally found between the level of annual bonuses and growth in sales. Profit as well as sales appears to have a positive impact on the bonuses paid to board chairmen; for other management board members there is a relationship between bonuses and shareholder value creation and profitability. No strong correlation was found between the growth in bonuses and performance, except for a weak correlation between growth in bonuses and profit for management board chairmen. Bonus levels are therefore influenced by performance, but their rate of growth is not.

One-off payments appear to be used mainly where sales figures are lower (perhaps due to divestments) but good scores are achieved on the other performance criteria.

Shares and options (long-term remuneration)

There is a strong relationship between relative shareholder value creation and option and share schemes. The movement in the value of options and shares after they have been granted cannot be simply explained on the basis of the four performance criteria; to some extent this is due to the limited availability of data.

Total remuneration

A positive correlation was found between the level of total remuneration and the relative shareholder value creation. There is also a relatively strong correlation with sales. The correlations are somewhat stronger for board chairmen than for other management board members. Profitability and earnings per share appear in only a few cases to make a substantial contribution to explaining the level of remuneration or movements in it.

5.7 *Redundancy schemes*

The study also looked at redundancy schemes.

International
No uniform international picture could be obtained on severance pay; there are major differences in practice between different countries. A trend can be observed towards laying down severance pay arrangements contractually in advance, with requirements of transparency (and to some extent of justifiability) influencing the amount paid. In many countries, severance pay is decided by negotiation when the employment contract ends. In other countries there is no corporate governance provision directly recommending the level of severance pay.

Amount of severance pay
The amount of severance pay varies widely. It depends on individual situations and contractual agreements, and can be influenced by the corporate governance climate. There are cases of exceptionally high payments to management board members, but also - especially in Germany - examples of former management board members who stay on as consultants to the company and who ultimately receive no severance pay. There is no clear picture of the total severance pay market, because of its historically limited transparency. Payments are higher in some countries (such as France and Belgium) than others (e.g. Germany and the Netherlands). In many countries, the amount of severance pay exceeds one year's salary. In addition, it is not unusual to include bonuses and pensions when setting the level of the payment.

Long-term remuneration
Where employment contracts are terminated involuntarily other than by way of summary dismissal, there are differences in the way outstanding options and shares are dealt with:

- immediate unconditional granting of all outstanding options and shares, without the time elapsed and/or performance being taken into account (especially in Belgium, Italy and to a lesser extent the US);
- immediate unconditional granting of all outstanding options and shares in proportion to the time elapsed and the performance up to the moment when the contract is ended (especially in the Netherlands, the UK and the US);
- normal granting in keeping with the prevailing scheme (especially in France and Sweden);
- all conditional rights lapse (especially in the US).

Mergers and acquisitions
Severance pay in the event of a merger or acquisition needs to be treated separately from other forms of severance pay. The outcome of merger or acquisition talks can often have direct consequences for the career of a management board member. The arrangements in such a situation should ensure that the management board member gives priority to the interests of the company at all times. This also

means that the severance pay often deviates from what would be paid on the normal ending of the employment contract. In general, severance pay tends to be higher in such cases than under normal circumstances. Estimates in several countries show that it can be between one and two times the annual salary.

The treatment of conditional options and shares during acquisitions and mergers is a specific situation. In the Netherlands, France, Sweden, Great Britain and the United States, the options and shares granted are in most cases rendered immediately unconditional. The pro rata granting of options and shares which applies in normal situations appears to be ignored in some acquisition situations. If there is a performance condition, the performance of the company up to the moment at which the share ceases to exist is often taken into account.

The Netherlands

In the Netherlands, more than half the 206 management board members who left their companies prematurely in the period 2002-2006 received severance pay. More specifically, 35% received an amount stated in the annual report; 16% received a different kind of payment and 3% received a combination of the two. Fewer than half (46%) of departing management board members received no specific payment.

In many cases, the reason for departure is not stated in the annual report. Nor is this required by either the law or the Code.

There is no clear trend in the level of severance pay, though the distribution shows a number of outliers in all years studied. The majority of chairmen received a payment which exceeded twice their annual salary. Since the study included all forms of departure, not just involuntary departure, it is not possible to say in how many cases the norm level of one year's salary (best practice provision II.2.7) was exceeded. This finding appears to be in line with the fairly infrequent application of this part of the Code as disclosed in annual reports. Companies can also comply with the Code by providing an explanation as to why they have not applied the best practice provisions, and make frequent use of this option for best practice provision II.2.7.

5.8 Conclusions and recommendations

Conclusions

Level of remuneration; performance criteria

1. The level of remuneration of Dutch management board members does not differ from that of their counterparts in other European countries. If the remuneration of chairmen of companies of comparable size (revenue of USD 500 million) is taken as the criterion, the pay of Dutch management board members is moderate in comparison with that of their European counterparts.

2. The total remuneration of Dutch management board members was significantly higher in 2006 than in 2002, which is in keeping with European practice. Companies too grew in size in this period. The remuneration level in large companies is higher and rises faster than in small companies. The remuneration of the chairman of the management board appears to rise faster than that of the other board members. An important component of the increase in total remuneration is the increase in the value of (conditional) awards of shares.

3. There is a fairly wide variety of performance criteria; financial criteria are applied significantly more frequently than qualitative criteria.

Process and role of the remuneration committee

4. The role of the remuneration committee is crucial in the negotiating process and in agreeing contract terms with a management board member. Given that there is an imperfect labour market, that the context is important and that there may be also be coalition formation, the key to a better understanding of management board remuneration appears to lie in the process rather than in the result.

5. A properly constituted and functioning remuneration committee is of crucial importance. The remuneration committee has the best chance of negotiating a remuneration contract successfully if its members have a sufficient knowledge of the company's organisation and of the remuneration instruments and if the committee is independent of the management board.

Structure; relationship between remuneration and company performance

6. There is a positive correlation in the Netherlands between shareholder value and the level of the overall remuneration. The cash bonus reflects a positive correlation with turnover and profitability. The award of shares and options is closely related to the creation of (relative) shareholder value.

Severance pay

7. The majority of management board members whose employment terminates early receive a severance payment. This is often in excess of one year's salary, which is the standard in the Code Internationally, severance pay is generally higher than one year's salary.

General
The survey carried out by the University of Groningen and Towers Perrin offers a fruitful basis for further study.

Recommendations (good practice)

General
8. Statutory measures that directly affect the level and structure of management board remuneration are expected to moderate executive pay only to a limited extent and may well detract from the position of the Netherlands as an attractive business location. This would also have an immediate impact on government finances. In other words, there is much to be said for restraint on the part of the government and the legislator. Unequal tax treatment of different variable (long-term) remuneration components might simply induce companies to compile a package of (variable) executive pay package designed to take maximum advantage of the tax laws and should not be expected to reduce total executive pay. This could also adversely affect the structure of the remuneration.

9. The Monitoring Committee considers that self-regulation is in principle a better instrument than legislation for influencing the level and structure of remuneration. This is also consistent with the purpose of the Code. However, self-regulation can be a serious alternative for legislation only if everyone makes an effort to comply with the Code: in other words, self-regulation requires self-discipline. The Monitoring Committee believes that improvement would be desirable in this respect. Self-regulation can be facilitated by more consultation between supervisory board members of different listed companies, for example by formulating best practices on the basis of the standards for action on remuneration policy.

10. The supervisory board is responsible for formulating the remuneration policy and determining the individual remuneration of management board members. The Monitoring Committee recognises that the supervisory board (i.e. the remuneration committee) has a difficult job. To assist the supervisory board the Monitoring Committee has produced guidance in the form of recommendations. As in previous years, a distinction is made here between the level of remuneration, the structure of remuneration and the process for achieving this. Like the previous recommendations of the Monitoring Committee, this guidance constitutes good practice.

Level of remuneration
11. Principle II.2 of the Code provides that the level (and structure) of the remuneration of management board members should be such that qualified and expert executives can be recruited and retained. The Code does not provide any criterion for reviewing whether the level is reasonable. As it stated in its report of December 2005, the Monitoring Committee does not believe that it would be

possible to formulate a universally applicable criterion for assessing the level of management board remuneration, if only because the market for management board members is imperfect.

12. Dutch companies are heavily engaged in the international market. This is true not only of the companies themselves but also of their management board members and staff. Determining the remuneration policy and the pay of individual management board members should remain a matter for the company,[14] with the supervisory board playing a central role as the de facto employer of the management board.

Process and role of the remuneration committee

13. In its report of December 2006 the Monitoring Committee described the independence of both the remuneration committee and any external remuneration consultant in relation to the management board as a key feature of the process for determining remuneration. Supervisory board members should therefore be sufficiently capable of providing counterweight to international customs and practices and to the opinions of consultants that tend to increase the complexity of remuneration contracts.

14. In order to support the independence of the remuneration committee the Monitoring Committee makes the following recommendations:

- The remuneration committee itself (not the remuneration consultant) should adopt the principles for the remuneration policy (including the use and composition of the peer group, the ratio of fixed to variable and short-term to long-term remuneration and the ratio of the remuneration of the chairman to that of other members of the management board).
- The remuneration committee (not the remuneration consultant) should take the initiative in determining the performance criteria. These performance criteria are derived from the indicators that are periodically used in assessing corporate and management board performance.
- If the remuneration committee makes use of these services of a consultant who provides a benchmark for determining the amount of management board remuneration, this consultant should be independent of the management board. It follows that the consultant concerned may accept other assignments from the company only in very exceptional circumstances and with the prior consent of the supervisory board (or the remuneration committee). When the occasion arises, this does not prevent another consultant working for the same organisation from accepting an assignment from the company, provided that there is sufficient assurance that the two consultants operate independently of each other.
- With the exception of an intake interview at the start of the process the remuneration consultant should not have any contact with the management board members unless the remuneration committee explicitly requests this.

[14] See also the letter of the Minister of Justice of 12 November 2007, Parliamentary Papers II 2006/07, 29 752, no. 5, pages 4-5.

- The discussions and negotiations with the management board members should be conducted exclusively by the remuneration committee (or its chairman), possibly in the presence of the chairman of the supervisory board and the remuneration consultant.

15. If remuneration other than fixed remuneration is to be awarded, the supervisory board should arrange for scenario analyses to be carried out periodically in order to identify any undesirable effects of the remuneration instruments that are employed. Account should be taken in this connection of special developments in the equity markets, the performance of the company and the performance of any peer group companies. The effects of possible mergers and acquisitions should also be taken into consideration. The scenario analysis should also cover voluntary and involuntary termination of employment.

16. The supervisory board should apply internal guidelines for a remuneration ceiling on the total remuneration package of the management board members.[15] This remuneration ceiling relates to the fixed salary, the short-term variable pay and the long-term variable pay on the date of grant. The supervisory board should state in the remuneration report whether a remuneration ceiling is applied internally.

17. If the variable pay is granted on the basis of incorrect financial or other data the supervisory board should have the possibility of adjusting it and the company should be entitled to reclaim from the management board member the variable pay granted on the basis of the incorrect data. This claw back clause should be disclosed.

18. In the case of new awards of variable pay to management board members based on quantified performance criteria, the supervisory board should be able to alter this in relation to the level of previous years if this would, in its opinion, produce unreasonable results, taking account of the remuneration policy adopted by the shareholders. The supervisory board should also have the power to alter existing conditional awards of variable pay based on quantified performance criteria if unaltered application would, in the opinion of the supervisory board, produce an unreasonable and unintended result. The supervisory board should exercise these powers only as a last resort. A passage to this effect is included in new remuneration contracts with management board members.

19. In order to prevent unlimited and unintended rises in variable pay the supervisory board should ensure that when short-term and/or long-term variable remuneration is granted each variable component cannot exceed a given maximum percentage of the fixed gross salary. The policy pursued

[15] In its report of December 2006 the Monitoring Committee indicated that a possible solution for making complex remuneration contracts more manageable (internally) may be the introduction of a pay ceiling. Such a ceiling would determine the total maximum value of the remuneration of a board member who scores 100% in respect of all performance criteria; for this purpose, the value of share-related remuneration elements (whether conditional or otherwise) would be determined at the moment they are granted. This ceiling would operate only internally and could contribute to the better manageability of remuneration for the supervisory board.

by the supervisory board with regard to the maximum ratio between fixed and variable remuneration should be disclosed by the company.

Structure; relationship between remuneration and corporate performance

20. Principle II.2 of the Code provides that the structure (and level) of the remuneration that the management board members receive should be such that the company can recruit qualified managers. In so far as the remuneration consists of a fixed and a variable part, the variable part should be related to previously determined, measurable and influenceable short-term and long-term objectives. The variable part of the remuneration is designed to reinforce the board members' commitment to the company and its objectives.

21. In its report of December 2006 the Monitoring Committee recommended that the remuneration policy and its results should be presented to the meeting of shareholders in clear and understandable terms. It is the job of the supervisory board to arrange for this; this means that it should monitor the complexity of remuneration contracts.

22. The Monitoring Committee notes that there is no single clear practice regarding accounting for management board remuneration in the financial statements and annual report. To have good information about the actual remuneration of management board members it is necessary to know both:

- the costs to the company of the remuneration, and
- all unconditional remuneration actually received by the management board member.

In its final report in 2008 the Monitoring Committee will examine possible ways of accounting for management board remuneration in a clear and transparent manner.

23. Best practice provision II.2.7, which regulates the maximum remuneration in the event of dismissal, should be extended to include all reasons for termination of employment. On the basis of best practice provision II.2.11 the main elements of the agreement reached with the management board member should be disclosed immediately.

- The Monitoring Committee recommends that severance pay be added to the list of elements that must be disclosed immediately, unless this would be contrary to an overriding interest of the company.
- The severance pay agreed in contracts with management board members should be in accordance with the remuneration policy adopted. When a management board member leaves the company, the remuneration committee should provide specific information about the severance pay in the report to the shareholders.

24. The Monitoring Committee recommends that the conditions for change-of-control clauses in contracts with management board members and for other prospective payments to management board members (whether in the form of securities or otherwise) should be immediately disclosed. Such

information should also be provided in the event of a resolution or motion of the management board in respect of a takeover or other important change in the nature of the company which is presented to the general meeting of shareholders and may result in the applicability of the compensation clause.

- Compensation for a change of control, whether or not granted under a term of the employment contract, should be based on a scheme included to this effect in the remuneration policy adopted.
- If a motion whose adoption result in a change-of-control clause becoming applicable is submitted by the management board to the general meeting for approval, the specific consequences of the application of the clause, should the motion be adopted, must be stated in the explanatory notes.

25. Best practice provision II.2.10 provides, inter alia, that the remuneration report should, if applicable, describe the performance criteria and provide an explanation of the criteria chosen. In its reports of December 2005 and December 2006 the Monitoring Committee recommended in particular that the relationship between 'remuneration and performance' should be made visible not only ex ante but also ex post. However, as a result of the variety of performance criteria used, the transparency of the criteria has diminished. Nor is the transparency enhanced by the often fairly general way in which qualitative objectives are described.

26. The Monitoring Committee considers that the relationship between the performance criteria and the strategic aims of the company should be disclosed in the remuneration report. The performance criteria should be sufficiently definite, quantified and specific for the extent of the true ambition to be apparent from them.

27. On the basis of best practice provision II.2.12 one-off payments are explained in the remuneration report. The Monitoring Committee recommends that if the company makes one-off (short-term) payments to management board members (other than the annual bonus), this should be based on a scheme included to this effect in the remuneration policy adopted.

Chapter 6. Diversity in the composition of supervisory boards

6.1 Introduction

The Monitoring Committee has noted that the position of women on management and supervisory boards is attracting increasing attention. Some people have advocated that the Code should specify a quota for women on supervisory boards. When receiving the second report on compliance with the Code in December 2006, the then State Secretary for Economic Affairs, Ms C.A. van Gennip, suggested to the Monitoring Committee that it give consideration to the position of women, partly in view of the relatively low rate of compliance with best practice provision III.1.3 (information about the supervisory board members in the report of the supervisory board) as regards gender.

The Monitoring Committee has decided to review the position of women on supervisory boards as one of the dimensions of diversity in the composition of the supervisory board, in addition to nationality, age, expertise and social background, in the context of the quality of the supervision as formulated in the Code. Principle III.2 provides that the composition of the supervisory board should be such that the members are able to operate independently of each other, the management board and any sectional interest. Principle III.3 deals with the composition of the supervisory board: the composition of the supervisory board should be such that it is able to carry out its duties properly. On the basis of principle III.3 each supervisory board member should be capable of assessing the broad outline of the overall policy and have the specific expertise needed in order to discharge the duties entailed by the role assigned to him within the framework of the supervisory board profile. Finally, principle III.4 deals with the role of the chairman of the supervisory board, stipulating for example that he should monitor the proper functioning of the supervisory board and its committees. In particular, best practice provision III.4.2 states that the chairman of the supervisory board should not be a former member of the management board of the company.

In addition to expertise, independence is a crucial requirement for a properly functioning supervisory board (see principle III.2 above). An important way of enabling the supervisory board to act independently is to ensure that it is of diverse composition. In its opinion of May 2007 submitted to the government, the Monitoring Committee recommended that the supervisory board should try to ensure that its composition is diverse and announced that it would return to this theme in this report.

The Monitoring Committee commissioned the University of Groningen (RuG) to carry out a study into diversity in the composition of supervisory boards of Dutch listed companies. In addition, the Monitoring Committee asked Ms T.A. Maas-de Brouwer and Mr A. Westerlaken to interview members of the supervisory boards about the functioning of their boards and the value of diversity in the composition of the supervisory boards.

The study by the University of Groningen is dealt with in section 6.2 below. Section 6.2 contains a report of the interviews. Conclusions are drawn about the study and the interviews in section 6.4. Finally, recommendations are made in section 6.5.

6.2 Results of the study of diversity in supervisory boards

Introduction

The University of Groningen studied the following questions:

- to what extent can a link be established, according to international research literature, between diversity in the composition of supervisory boards or, as the case may be, boards of directors and corporate performance?
- how has diversity in the composition of supervisory boards evolved in Dutch listed companies in the past decade (actual diversity)?
- to what extent do Dutch listed companies endeavour to increase diversity in the composition of supervisory boards (intended diversity)?

The study of the second and third questions (i.e. actual diversity and intended diversity respectively) comprises around 70 Dutch listed companies that were included in the AEX, AMX or AScX indices in the first quarter of 2002 and 2007.
Actual diversity has been examined by reference to a number of specific features of diversity, such as gender, age, nationality and expertise, in the annual reports for the 2001 and 2006 financial years. The intended diversity has been determined by reference to the profiles of the selected companies.

Literature

The literature study can be subdivided into three categories: theoretical research into the effects of diversity, empirical research into diversity in supervisory boards in the Netherlands and boards of directors abroad and empirical research into the link between diversity and corporate performance.

It is sometimes argued in the literature (particularly the Anglo-American literature) that diversity enhances the quality and effectiveness of board decision-making, thereby increasing the shareholder value of the company. In support of this argument it is suggested that diversity promotes an independent position of the board, that boards with a diverse composition have more members with unique qualities and that diversity provides access to a larger variety of external resources (management talent, expertise, funding and political or legislative authorities), in short a larger network.

The academic (socio-psychological) literature identifies positive and negative effects of diversity in groups. The ‘value in diversity’ theory states that a variety of backgrounds results in a variety of views, which in turns results in better decisions. However, selecting the best solution costs more time in teams of varied composition than in more homogenous groups. This is why it is stressed that diversity can be of particular value in relation to decisions that require a creative approach, and that homogeneity tends to produce better results above all in crisis situations. According to the social categorisation theory, diversity can result in a lack of identification by individuals with their team and a lack of the social integration needed for effective decision-making.

It is also stated that diversity can have symbolic consequences and communicative effects. As outsiders are said to be able to identify more easily with teams of diverse composition, such teams can communicate better with the outside world.

The literature on diversity in supervisory boards/boards of directors abroad in terms of gender and nationality reveals the following picture:

Table 6.1

Country	Year	Percentage of women	Percentage of foreigners
United States	2006	16	6
United Kingdom	2006	15	27
Sweden	2004	20	19
Germany – workers' representatives	2004	20	1
Germany – shareholders' representatives	2004	3	15
Spain*	2005	4	10
Italy*	2006	4	24
The Netherlands (on basis of RuG's own study)	2006	8	31

The percentage of women on boards of directors in the countries concerned was highest in Sweden (20%), the United States (16%) and the United Kingdom (15%). The Netherlands has a relatively low percentage of women on supervisory boards.
The Netherlands, the United Kingdom and Sweden have a relatively high percentage of foreigners on boards of directors, compared with a relatively low percentage in the United States, Spain and Germany.

The results of the mainly Anglo-American empirical research into the relationship between diversity and corporate performance are as yet far from clear. This may be due to the existence of a reverse causal connection (if a company is doing badly it may come under increasing pressure to appoint independent outsiders) and to the possibility that other factors can play a role in assessing corporate performance.

The findings in the academic literature on the effects of diversity in groups within organisations in general are also limited. Teams that are of diverse competition in terms of expertise, training and background produce more innovative ideas and take decisions of a higher quality. As against this, deliberations take longer, which results in process losses. Diversity in terms of gender and age was not found to have any positive effects on the decision-making process, and there was scarcely any research into diversity in terms of nationality.

* The percentages apply to the entire board of directors, including the executive members.

Diversity of supervisory boards in the Netherlands

Actual diversity

The study examined the composition of the supervisory boards of about 70 companies in 2001 and 2006. The average number of women rose from 6% to 8%. The average number of foreigners rose from 24% to 31%. The number of different nationalities also rose. The average age rose slightly (from 61 to 62), and the difference in age increased. Although the differences in educational level decreased, the diversity in courses of study, expertise and background widened.

The term of office and number of members of each supervisory board were also studied. The average term of office fell from over five years to over four years, and the difference in the terms of office also narrowed. The number of members per supervisory board remained more or less constant (6). There were statistically significant differences in terms of expertise, background[16] and average term of office between 2001 and 2006.

Intended diversity

The supervisory board profiles of 72 companies were studied in connection with the intended diversity. Over two thirds of the profiles referred to the Code's requirements for the independence of supervisory board members (best practice provision III.2.2). Half of them, particularly the AScX companies, expressly mentioned the limitations in respect of the position of former management board members (best practice provisions III.2.2 and III.4.2). Around a fifth of the companies explicitly reported a cap on the number of non-executive directorships that may be held (best practice provision III.3.4).

The profiles were also examined to ascertain the desired experience and expertise and the desired personal qualities. There are no significant differences between the results of the different indices. As regards the desired experience and expertise there are four aspects that a clear majority of companies seek in a prospective supervisory board member: financial expertise (84%), international experience (80%), affinity with the product/market in which the company operates (71%) and general management experience (64%). Knowledge of the social and political setting (58%) and knowledge of HR (51%) are sought by a majority of the companies. Relatively few companies expressly ask for experience at management board level (10%), strategic knowledge (12%) or R&D know-how (12%).

The results in respect of the desired personal qualities are less clear. The personal qualities most frequently mentioned are availability (45%), critical attitude (43%) and team spirit (35%). Availability is considered important mainly by AEX companies, whereas a critical attitude and team spirit are mentioned more frequently by AScX companies.

Finally, the study examined whether aspects that would enhance diversity were expressly mentioned in the profiles. This occurs only to a limited extent. Where it does occur, the requirements are mainly a

[16] Very few data are available on the background in 2001. This may affect the results.

mix of operationally active and former management board members and age (28% and 14% respectively). Here too the emphasis varies from index to index. Whereas the AEX companies attach importance above all to international experience (33%), the AMX companies put the emphasis on a mixed composition in terms of age (30%). The AScX companies also try to attract people from outside the business community (27%). Express attempts are made to have more women on supervisory boards in 10% of cases (in particular AEX companies).

6.3 Findings from the interviews

Introduction

In the autumn of 2007 29 supervisory board members[17] of listed companies established in the Netherlands were interviewed for the study, 27 of them by Ms T.A. Maas-de Brouwer and Mr A. Westerlaken and the remaining two by Professor K. Cools, member of the Monitoring Committee. The purpose of the interviews was to obtain the views of the supervisory board members on the functioning of the supervisory boards and on the value of diversity in board composition.

The diversity of the interviewees was as follows:

- 21 men and 8 women
- 23 Dutch nationals and 6 foreigners
- 9 forty-year-olds (youngest 41), 8 fifty-year-olds, 11 sixty-year-olds and 1 seventy-year-old (71)
- 24 from trade and industry, 2 from consultancy, 2 from politics/civil service and 1 from academic life

The interviewers consider it important to note that all the supervisory board members had prepared thoroughly for the interview and generally gave the impression of feeling very closely involved in their company and in the thinking on the role of diversity in the composition of the supervisory board.

Functioning of the supervisory board

The interviews show that many supervisory board members consider the following elements to be essential to the proper functioning of the supervisory board:

- expertise
- independence
- good team spirit.

The interviewees stated that the supervisory board should above all have sufficient expertise. It should have the capacity to gauge situations and take a broad view. Some interviewees considered that all members of the board should be able to assess all aspects of the company in broad outline, including the financial documents, whereas others attached greater importance to ensuring that the board as a whole has all the necessary expertise. Independence means that the supervisory board should take an independent position and ask critical questions. The team spirit of the supervisory board was also considered important: i.e. open debate, a good working atmosphere, mutual trust and interpersonal chemistry. There should also be an open relationship between the management board/CEO and the supervisory board; the management board/CEO should dare to be vulnerable. The chairman of the supervisory board plays an important role in this connection. He should enable everyone to express an opinion and be open and should forge a good team.

[17] The following supervisory board members were interviewed: E. van Amerongen, G.J. de Boer-Kruijt, F. Blaisse, Th. M. Cohn, J.M.L. van Engelen, A.M. Fentener van Vlissingen, F. Fröhlich, M. de Groen, M. Harris, J. M. Hessels, P. Houben, F. van Houten, G. Kampouri-Monnas, E. Kist, W. de Kleuver, W. Kok, C. van Lede, A.M. Llopis Rivas, E. van der Merwe, H. Noten, A. Roobeek, F.H. Schreve, O. Strauss, T. de Swaan, M. Tiemstra, P. Verboom, R. van der Vlist, P. Visee and E. Westerink.

Some interviewees expressly mentioned diversity as a condition for a properly functioning supervisory board: i.e. a balance between different specialisms and skills and between knowledge and experience; in short, members who have 'a full life'. The commitment of the supervisory board was considered an important factor in times of crisis. Regular meetings were also regarded as essential to the proper functioning of the supervisory board. Supervisory board members should acquaint themselves with the corporate culture, the key employees within the company and (in the case of a foreigner) the culture of the country concerned. They serve as the company's 'signboard'. One interviewee stated that the supervisory board should strike a balance between distance and commitment, and another stated that a good supervisory board should give the management board the freedom to operate while at the same time closely monitoring the risks and, where necessary, exerting pressure.

Criteria for composition of supervisory board

The supervisory board members were asked what criteria should govern the composition of the supervisory board. According to a large number of interviewees, the supervisory board should adopt a critical attitude, be of service to the company, be able to focus on the broad outline, and possess experience and powers of persuasion. In addition, the supervisory board should be able to switch smoothly between its supervisory and advisory roles and between a passive and an active role.

Many interviewees stated that a diverse composition of the supervisory board should be a criterion. Every supervisory board should possess certain expertise, such as knowledge of the core activities of the company and financial expertise. Diversity in terms of gender and age was also considered useful by some supervisory board members. The need for different expertise may depend on the nature and strategy of the company. The composition of the supervisory board should reflect the company's main markets through the presence of a supervisory board member who comes from or is familiar with these markets. According to some interviewees, however, the core of the supervisory board should consist of Dutch nationals. Here too reference was made to the chairman's role in forging a team. One interviewee considered that the supervisory board should not consist exclusively of former CEOs.

Independence of supervisory board members

In addition to expertise, the Code identifies independence from the executive board as an essential quality of supervisory board members. Most supervisory board members regard independence as a character trait: a critical attitude, ability to form an opinion independently, no 'yes men'. An independent supervisory board member should dare to demand relevant information from the management board and to disagree with the management board. Independence can also be formally defined as not being in receipt of other income from the company and not having any conflicts of interest with the company. Some supervisory board members also stated that independence means that supervisory board members should receive fixed, non-performance-related remuneration and not have shares in the company. As one interviewee stated, if you don't have a financial stake you have a different view of things. Another believed that shares in the company are not an obstacle to independence. According to some interviewees, independence could be promoted by ensuring that

people do not remain supervisory board members for too long with the same company and do not hold several non-executive directorships. The chairman should in any event be independent. According to some interviewees, former management board members could play a useful role on the supervisory board, albeit not as chairman or immediately after their retirement.

Some supervisory board members considered that too much emphasis was put on independence, and that commitment and good contact with the management board were perhaps more important. Independence was considered by one supervisory board member to be a factor mainly in relation to supervision and by another to be a factor in relation to specific problems. Independence is a means to an end and not an end in itself, according to one supervisory board member.

One-tier or two-tier structure

Some interviewees expressed a preference for a one-tier board and others for a two-tier board, while a third group felt that it did not make much difference. Those with a preference for a one-tier board pointed to the greater commitment, the less complex decision-making process and hence the reduced inclination to compromise, and the advantage of short lines of communication in times of crisis. Those with a preference for a two-tier system cited as advantages the greater independence of the supervisory board, the better separation of management and supervision, and the fact that less emphasis is put exclusively on the interests of the shareholders. Mention was also made of the fact that in a one-tier model a large board of directors is less able to act decisively. One interviewee mentioned the role of the chairman, who can influence the de facto operation of the supervisory board in such a way that the company moves towards a one-tier structure or retains a two-tier structure.

Importance of diversity in the supervisory board

The interviewees were asked whether they considered diversity in the composition of supervisory boards important. Some considered that diversity enhanced the quality of the supervisory board by bringing a broader view, a different perspective and greater understanding and allowing better analysis and decision-making and more creative solutions. Some considered it important for the supervisory board to be a reflection of society. Some believed that the importance of diversity depends on the nature of the company. One interviewee argued that supervisory boards should no longer be a male bastion. And another preferred the term ‘pluriformity’ to diversity.

According to some supervisory board members, diversity could help the board to adopt a more independent position. This could be beneficial, especially in the case of ‘big deals’. One supervisory board member considered that a varied composition also reflected well on the company in the eyes of customers. Negative effects of diversity mentioned by the interviewees were that cultural differences could make communication more difficult and that some foreign supervisory board members were not familiar with the political climate in the Netherlands.

The interviewees were asked which aspect of diversity they considered the most important. Gender, age, nationality, social background and specialism were all mentioned by one or more supervisory board members as the most important aspect. Around half of the supervisory board members stated that women have an added value in the supervisory board. Five interviewees considered that the subject of women on the supervisory board was not really an issue; it is the quality of the individual members that matters. Another interviewee felt that it was a matter of equality: a given percentage of women should be represented on supervisory boards. Around half also mentioned specialism/expertise as an important aspect. Nationality/experience abroad was considered important by around a third of the interviewees. About a quarter of the interviewees said that age was an important aspect. Social background was mentioned by around a fifth of the supervisory board members.

Limits on diversity

Some interviewees considered that the quality of the supervisory board should take precedence and that diversity was subordinate to this. One interviewee took the view that diversity and quality were at odds with one another. Diversity could also undermine teamwork. According to another interviewee, diversity and quality should be combined. To have a good composition, a supervisory board also needed some generalists. Yet another interviewee felt that no limits should be set on diversity. According to one supervisory board member, the nature of the company determines the degree of diversity and the capacity to be a good supervisory board member.

Aspects of diversity

The interviewees dealt with the different aspects of diversity: gender, age, nationality, specialism and social background. Some supervisory board members believed that women have a different perspective and take a fresh and original view of problems. They also stated that women are more aware of interests other than those of shareholders, for example the interests of staff, customers and corporate image. Some interviewees said it was hard to find good women members, but others argued that this showed they could not have been looking properly. Some supervisory board members were in favour of (statutory) measures to promote the position of women, whereas others considered that this was unnecessary or might prove counterproductive. Some believed that a supervisory board benefits from having members who have a full life and are active in an executive position. According to one interviewee, the longer supervisory board members are ‘out of the action’ the better able they are to view problems more simply and abstractly. One interviewee stressed that it was sometimes hard to find such people owing to the demands on their time and the element of career planning. The aspects of nationality, specialism and social background were said to be related to the nature of the company.

6.4. Conclusions

The Monitoring Committee commissioned a study of diversity in supervisory boards and arranged for about thirty supervisory board members of Dutch listed companies to be interviewed. The literature consulted does not contain clear conclusions on the effects of diversity in supervisory boards on corporate performance. Of the aspects of diversity studied, expertise would appear to have the most positive impact. As virtually all the studies relate to one-tier boards or groups in companies in general, no conclusions can be drawn from this study about how diversity in Dutch supervisory boards impacts corporate performance.

However, a few general conclusions can be drawn on the basis of the arguments used in the academic literature, combined with the results of the interviews. The study and the interviews show that a varied composition of the supervisory board can enhance the quality of the decisions. However, it takes more time to reach a decision. In times of crisis the aspect of time is more important. In addition, an unduly varied composition of the supervisory board can be at the expense of team spirit and the members' sense of involvement with the company. The interviewees emphasised the importance of the chairman in fostering team spirit and an independent attitude.

The study and the interviews also show that supervisory board members are increasingly professional and specialised. It can be concluded from the interviews that the aspects of nationality, expertise and background are more dependent on the nature of the company than the aspects of gender and age. Given the importance of foreign markets to Dutch listed companies, it is hardly surprising that they have a relatively large number of foreigners on their supervisory board. The number of women on supervisory boards is relatively low in the Netherlands.

On the basis of the study and the interviews the Monitoring Committee comes to the following conclusions:

- expertise, commitment and independence are essential to the proper functioning of a supervisory board;
- diversity can enhance the quality of the decision-making in the supervisory board in terms of expertise and independence;
- the composition of the supervisory board should not be too diverse as this can reduce commitment;
- the role of the chairman is important in forging team spirit.

6.5. Recommendations

Principle III.2 provides that the supervisory board should be composed in such a way that the members are able to operate independently of each other, the management board and any sectional interest. In addition to expertise, independence is a crucial requirement for a properly functioning supervisory board. An important way of enabling the supervisory board to act independently is to ensure that it is of diverse composition. In its opinion of May 2007 submitted to the government, the Monitoring Committee recommended that the supervisory board should try to ensure that its composition is diverse.

The Monitoring Committee has defined five aspects of diversity in the composition of the supervisory board: gender, nationality, age, expertise and social background. It recognises that the gender of a supervisory board member need not exclusively be regarded as an aspect of diversity, but is of the opinion that the representation of women should also be viewed in the context of equal treatment. The diversity perspective implies that women have a different attitude to business than men.

In particular, the position of women on supervisory boards has been a matter of debate recently. Some people have advocated that the Code should specify a quota for women on supervisory boards. The Monitoring Committee notes that the percentage of women on the supervisory boards of Dutch listed companies is relatively low. It points out that companies have a direct interest in encouraging women to take top positions. An important determinant of success for companies is their ability to attract and retain talent. If half of the population are underutilised, this means that half of the available talent is underutilised. The Monitoring Committee therefore invites supervisory board members and other stakeholders to examine how the position of women in the private sector can be improved. However, on the basis of its remit and the survey findings, the Monitoring Committee does not see any reason to include a quota in the Code for the number of women on supervisory boards.

A modern company can therefore be expected to develop, apply and account for a diversity policy. The diversity policy is reflected, among other things, in the profile and appointment policy for the supervisory board. The Monitoring Committee considers it important for the supervisory board to have a diverse composition, because this can enhance its independence and quality. Both the selection and appointment committee and the chairman of the supervisory board play an important role in determining the composition of the team of supervisory board members and its functioning.

Article III.5.13 of the Code regulates the duties and activities of the selection and appointment committee of the supervisory board. The Monitoring Committee considers it important that the selection and appointment committee should take explicit account in its work of the diversity policy formulated by the company.

Greater diversity in the supervisory board's composition can be achieved either by increasing supply or by encouraging demand. The point is that supervisory boards should become aware of the availability of candidates whose nomination is not immediately obvious. People who are below the level of the management board of large companies or other civic organisations can also be suitable candidates for membership of the supervisory board of smaller companies. A more open process of recruiting candidates for supervisory board membership would help to bring vacancies to the attention of potential candidates and bring potential candidates to the attention of the board. Companies could also give management board members and employees more scope to accept supervisory board memberships with other companies, provided this does not conflict with their own interests as employer. The survey shows that the average age of supervisory board members is 62. The Monitoring Committee invites supervisory boards to aim for greater diversity in terms of age as well.

Good use of the instrument of evaluation can also influence the diversity of composition. Serious periodic evaluation can improve the supervisory board's functioning and, when a supervisory board member is replaced, the board can expressly decide to aim for greater diversity in the interests of improving quality.

The Monitoring Committee would point out, by the way, that the quality of the functioning of the supervisory board is determined not only by diversity but also by expertise, personal involvement and continuity as well as effectiveness. It would not therefore seem worthwhile increasing the number of supervisory board members simply in order to increase diversity. The Monitoring Committee would also point out that diversity should not be at the expense of team spirit in the supervisory board.

In the light of the above, the Monitoring Committee makes the following recommendations:

1. the Monitoring Committee recommends that the supervisory board (at the suggestion of the selection and appointment committee) should expressly deal in its profile with the diversity aspects relevant to the company and explain how they are applied in practice;
2. the Monitoring Committee recommends that candidates for new vacancies on the supervisory board should also be recruited outside the existing networks;
3. the Monitoring Committee recommends that the supervisory board should aim for a mixed composition. The diversity of its composition could be increased above all in terms of gender.

Composition of Corporate Governance Code Monitoring Committee

Chairman

Professor Jean Frijns
Professor of Investments at the Vrije University of Amsterdam
Former asset management director and member of the board of the ABP Pension Fund

Members

Professor Kees Cools RA
Professor of corporate financing and strategy at the University of Groningen
Partner in The Boston Consulting Group

Gert-Jan Kramer
Former president of Fugro NV
Various non-executive directorships

Professor René Maatman
Professor of Asset Management, Radboud University Nijmegen,
Head of the Legal and Tax Department of ABP Vermogensbeheer

Professor Jaap van Manen RA
Professor of Auditing at the University of Groningen
Partner PricewaterhouseCoopers Accountants NV

Ms Kitty Roozemond
Director of the Association of Provincial Authorities
Former vice-chair of the Federation of Netherlands Trade Unions (FNV)

Jos Streppel
Member of the Management Board and Chief Financial Officer, Aegon NV
Member of the Supervisory Board of KPN NV
Member of the Supervisory Board of Van Lanschot NV
Chairman of the Shareholders Communication Channel Foundation

Professor Albert Verdam
Professor of company law at the Vrije University of Amsterdam
Legal adviser to Royal Philips Electronics NV

Advisor

Sven Dumoulin
Group Secretary to Unilever NV and Unilever PLC
Former Professor of company law at the University of Tilburg

Secretariat

Wouter Kuijpers
Financial Markets Directorate, Ministry of Finance

Ms Martha Meinema
Enterprise Directorate, Ministry of Economic Affairs