

Comment Letter on EU Proposal on Independent Directors' Responsibilities, May 2004

May 26, 2004

Mr. Pierre Delsaux
Head of Unit
DG MARKT G3
European Commission
B-1049
Brussels, Belgium

Dear Mr. Delsaux:

The Investment Company Institute appreciates the opportunity to comment on the Consultation Document regarding the Recommendation on the Role of Independent Directors (Consultation Document). The Institute is the national association of the US investment company industry.¹ Our members manage approximately 1,000 US funds (with over \$569 billion in assets) that have a global or international focus, and many of these global and international funds invest in Europe. Moreover, many of our members manage investment companies and pension funds outside the United States, including mutual funds domiciled in the European Union that are sold under the EU UCITS Directive. Our comments reflect their experiences both investing and managing assets in the European Union.

As an initial matter, we again applaud the Commission for working so quickly towards implementing another item on the EU's Corporate Governance Action Plan. We understand that the Commission expects to adopt the recommendation on the role of independent directors in early autumn 2004. We believe that independent directors play an extremely important role in protecting investors and a Commission recommendation regarding the responsibilities of independent directors will provide directors and companies with useful tools to ensure the effectiveness of independent directors.

In the Consultation Document, the Commission requests that responses be concise. Accordingly, this letter addresses the most significant issues raised by the Consultation Document. Although the short timeframe for comment did not afford us an opportunity to reflect at length on the issues raised by the Consultation Document, we hope that you find our comments useful.

I. Form and Scope of the Commission's Recommendation

Rather than propose EU-wide legislation, the Commission intends to make a recommendation to Member States that they introduce in their national framework a set of detailed principles with which listed companies must comply or explain the basis for any deviation. We support the Commission's approach and agree that the recommendation should cover EU-listed companies having their registered office in a Member State. We also agree that Member States should have flexibility to introduce binding requirements if appropriate.

II. Board Composition

In the Consultation Document, the Commission states that, in view of the different legal systems in Member States, it does not seem desirable to recommend the number of independent directors that should be on the board. Instead, the Commission intends to include a statement that the number of independent directors should be adequate in relation to the total number of "non-executive or supervisory directors and significant in terms of representatives."

We suggest that, at a minimum, the Commission should state in the recommendation that the number of independent directors should be adequate in relation to the total number of directors (both executive and non-executive) on the board. We believe that a significant number of independent directors vis-à-vis the number of executive or managing directors is necessary to ensure

independence and effective oversight of corporate management.

Moreover, we recommend that the Commission request Member States to consider whether independent directors should constitute a majority of the board. We believe that having at least a majority of independent directors on boards would help to assure that independent directors have the ability to control the voting process, particularly on matters involving potential conflicts of interest with management.

III. Profile of Independent Directors

A. Qualifications

The Commission intends to include in the recommendation a statement that the board should draw up a desired profile of itself and evaluate it periodically. Moreover, boards would be required to ensure that they are composed of members who, as a whole, have the required diversity of knowledge, judgment, and experience to complete properly their tasks. The Commission also intends to recommend greater transparency with respect to the qualifications of directors by requiring disclosure of a director's particular competencies and the reasons why he or she is qualified to serve on the board when the appointment of a director is proposed and every year in the annual report. We generally agree that these recommendations would be useful and encourage good corporate governance.

B. Commitments

The Commission intends to recommend a general statement about the importance of directors being available and to recommend disclosure, at the time an appointment of a director is proposed, of the director's other significant commitments with a broad indication of the time involved. This type of information also would be required in the annual report. The Commission, however, does not intend to include a limitation on the number of directorships that should be held by directors.

We agree that it would be inappropriate to limit the number of directorships. Any number recommended would be arbitrary and not necessarily appropriate in all circumstances. Directors have varying commitments both inside and outside the boardrooms, and the ability of a director to serve adequately on a board will depend on a variety of factors. We are of the view that it would be more appropriate for the Commission to remind directors of their responsibilities and the time commitment that such responsibilities would likely entail and to require certain transparency in this area.²

C. Independence

The Commission intends to include in the recommendation a general statement regarding director's independence and to provide nine minimum criteria for independence. We generally agree with the criteria proposed by the Commission. We, however, do question one criterion – that to be independent, a director may not have served on the board for more than 12 years. We do not believe that the length of service on the board in itself is indicative of a lack of independence. In fact, a long-serving independent director may know more about the company and be able to appreciate more readily conflicts of interest situations. We also question the reason why the Commission chose 12 versus another number of years.

We support the Commission's intention to place the ultimate responsibility of determining independence on the board itself and to require companies to provide adequate disclosure of its independent directors and the grounds on which the companies have determined them to be independent. We also believe that the Commission's intention to include a statement about the duties of independent directors – i.e., their obligation to maintain in all circumstances their independence of analysis, decision, and action, not to seek or accept any unreasonable advantages that could be considered as compromising their independence, and to express clearly opposition in the event that a decision of the board may harm the company – will help to clarify the expectations of directors.

IV. Board Committees

The Commission intends to include as a best practice the creation of the nomination, remuneration, and audit committees within the board. We understand that the recommendation will provide for certain flexibility by not requiring the creation of three specific committees but, rather, requiring that the functions traditionally assigned to those committees be performed. In the recommendation, the Commission intends to address the composition, role, operation and transparency of these committees.

We support the Commission's intention to recommend that Member States require that the functions traditionally associated with nomination, remuneration, and audit committees of the board be performed for all EU-listed companies. As a preliminary matter, we agree with the Commission that these committees should not remove matters from the board's consideration but facilitate efficiency of the board's work by ensuring that decisions are based on due consideration and ensure that the decisions taken by the board are free from material conflicts of interest. With respect to the minimum standards for each of the committees related to composition, role, operation, and transparency, we believe that they generally appear to be appropriate. We discuss in more detail below some

concerns that we have with several committee features that the Commission intends to include in the recommendation.

A. Composition of Committees

1. Nomination Committee

The Commission intends to recommend that the nomination committee be composed of a majority of independent directors. In addition, the Commission intends to state explicitly that the chief executive officer must be among the members of the nomination committee in companies with a unitary board or adequately consulted in companies with a dual board and where the chairman of the managing board cannot be a member of the nomination committee.

We agree with the Commission that the nomination committee should be composed of a majority of independent directors and urge the Commission to recommend that the nomination of independent directors be entirely in the hands of independent directors. We disagree, however, with the Commission that companies should be required to have the CEO be closely involved in the nomination process. We question why it is necessary for the CEO to be always involved in the nomination of directors. We believe that allowing some executive directors to participate in the nomination committee (i.e., only a majority of the committee has to be independent) would ensure proper input from executives and would be sufficient to permit CEOs to be a member of the nomination committee if it is appropriate under the specific circumstances.

2. Remuneration Committee

The Commission intends to recommend that the remuneration committee be composed exclusively of non-executive or supervisory directors who are in the majority independent. We generally support the Commission's proposal for the composition of the remuneration committee but are of the view that, for the remuneration of independent directors, only independent directors should be involved. We believe that placing control over compensation, of at least the independent directors, in the hands of independent directors and not with executive or managing directors would help to ensure the independence and effectiveness of the board.

3. Audit Committee

The Commission also intends to require that the audit committee be composed exclusively of non-executive or supervisory directors who are in the majority independent. We recommend that audit committees be composed entirely of independent directors.

B. Role of Committees

With respect to the role of the remuneration committee, the Commission intends to make a series of statements including that the committee should make proposals to the board regarding the remuneration policy for executive or managing directors, the individual remuneration to executive or managing directors, and the standard form of contract for executive or managing directors. We question whether it is the proper role of a board committee to make these specific proposals rather than to oversee the remuneration policy and individual remunerations. Given that the Commission envisions this committee to be composed exclusively of non-executive or supervisory directors, we wonder whether it would be more appropriate for the external directors to provide proper oversight of, rather than to undertake, these responsibilities.

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We appreciate the opportunity to comment on the Commission's Consultation Document on the responsibilities of independent directors. If we can provide any other information or if you would like to discuss further any issues, please contact me at podesta@ici.org or at (202) 326-5826 or Jennifer Choi at jchoi@ici.org or at (202) 326-5810.

Sincerely,

Mary S. Podesta
Senior Counsel

cc: Jean-Yves Muyelle

ENDNOTES

¹ Our membership includes 8,632 open-end investment companies ("mutual funds"), 632 closed-end investment companies, 126 exchange-traded funds, and 5 sponsors of unit investment trusts. Our mutual fund members have assets in excess of \$7.5 trillion, accounting for approximately 95% of total industry assets. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

² We believe it would be appropriate, for example, to require disclosure of directors' service on other boards. We, however, do not believe disclosure should be required of directors' personal commitments.

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