The Dutch

CORPORATE GOVERNANCE CODE

Proposal for applicability Corporate Governance Code to one-tier boards

AN INVITATION TO COMMENT

UNOFFICIAL TRANSLATION

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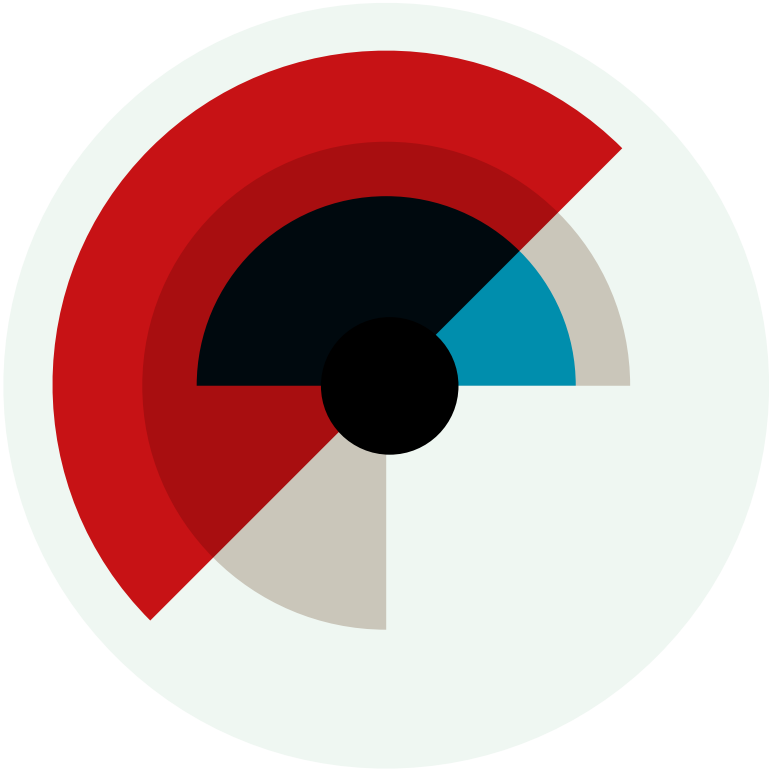

PROPOSAL FOR APPLICABILITY OF DUTCH CORPORATE GOVERNANCE CODE TO ONE-TIER BOARDS

In this consultation document, the Corporate Governance Code Monitoring Committee (hereinafter: the Committee) presents a proposal for the application of the Dutch Corporate Governance Code (hereinafter: the Code) by companies with a one-tier board.

All stakeholders and interested parties are invited to respond to this consultation document. The goal of the Committee is to use the input received to develop clear guidelines for how the principles and best-practice provisions laid down in the Code can be applied by companies with a one-tier board.

The consultation period will last for eight weeks, from 3 August through 28 September 2016. Please send your comments to secretariaat@mccg.nl by 28 September 2016 at the latest.

This document is based on the text of the proposal for revision of the Code that was published on 11 February 2016. You are kindly requested to limit your observations to proposals for the applicability of the Code at companies with a one-tier board. The Committee is already addressing the substantive comments and observations submitted in response to the proposal for revision of the Code, so it is not necessary to repeat this process.

Your response will be published on the Committee's website, unless you indicate that you would prefer otherwise.

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1. INTRODUCTION

Traditionally, companies in the Netherlands have adhered to a two-tier board model. Accordingly, the Dutch Corporate Governance Code is based on this model. In a company with a two-tier board, administrative and supervisory responsibilities are divided between two corporate bodies, i.e. the executive board and the supervisory board. Companies with a one-tier board have one corporate body, composed of both executive directors and non-executive directors, in which the latter supervise the former. In a one-tier board, the position of 'commissioner' (*commissaris*) does not exist. Non-executive directors and executive directors carry collective responsibility for the company's management.

Advantages cited regarding a one-tier board include a better flow of information from the executive directors and greater involvement and increased decisiveness on the part of the non-executive directors. At the same time, the fact that there is not always a clear distinction between supervision and executive responsibilities in a one-tier board necessitates additional attention to ensure proper supervision. In general, it should be noted that the formal distinction between one-tier and two-tier boards is less significant now than in the past. At an international level, a convergence of these board models is taking place. Supervisory boards have professionalised in recent years and are increasingly actively involved. At the same time, the traditional role of non-executive directors is moving in the direction of that of the 'commissioner', in light of the increased focus on long-term strategy and the strengthened position in relation to executive directors. This convergence is possibly further reinforced by the increasing trend among of companies to establishing executive committees.

Reason for further elaboration

One-tier boards are already, to a limited extent, addressed in the current Code: Principle III.8 and best-practice provisions III.8.1 through III.8.4 have been part of the Code since 2003. In Section 10 of the Preamble, it was noted that i) a few Dutch listed companies had already established one-tier boards and ii) now that the statute for *Societates Europaea* (SE) permitted both options, the number of Dutch listed companies with one-tier boards would increase in the future. To ensure that the Code would take into account future developments and scenarios, the decision was taken at the time to incorporate the principle and the best-practice provisions for one-tier boards into the Code. Since then, the wording has remained unaltered.

Although the majority of companies that fall within the scope of the Code have a two-tier board, companies seem to be opting increasingly for a one-tier board system.[1] This is the case primarily with respect to Dutch companies listed abroad (which may or may not be their primary listing). The increase in the number of companies with a one-tier board can probably be attributed to the entry into force of the Management and Supervision Act (*Wet bestuur en toezicht*) on 1 January 2013. This act lays down the statutory requirements applying to a one-tier board.[2] It clarifies the extent to which managerial and supervisory tasks can be divided among directors and what consequences this has regarding professional liability.[3] An important reason for introducing the possibility of working with one-tier boards in Dutch company law was to facilitate the use of Dutch capital companies in national and international relationships. The amendments also fit with the European principle of freedom of establishment.

1 Cf. A.A. Bootsma & J.B.S. Hijink, 'De beurs-NV in den vreemde', *Ondernemingsrecht* 2014/15 (in Dutch), and the literature cited in it.
2 Section 2:129a of the Dutch Civil Code.
3 *Dutch House of Lords Parliamentary Papers* 2010/11, 31 763, C, p. 2.

Due to both the developments in legislation and the increase in the number of companies with one-tier boards, the Committee deems it useful to further clarify how the Code can be applied by such companies. The goal is to provide companies with a one-tier board and shareholders a guideline for applying the Code.

Rationale of measures proposed

In 'translating' the Code to one-tier boards, it is not sufficient to engage in the linguistic exercise of replacing every reference to the "supervisory board" with "non-executive directors" and every reference to the "board" with "executive directors". The process is more complex than this. Non-executive directors are part of the same corporate body as the executive directors; in other words, they are all directors. As such, the task of non-executive directors is broader than that of supervisory board members in a two-tier system. At the same time, specific supervisory tasks are reserved for non-executive directors on a one-tier board.

The Committee proposes to clarify the application of the Code by companies with a one-tier board as follows. First, the principle and the best-practice provisions in the current Code that apply to one-tier boards will be amended and expanded. This principle and the best-practice provisions will be added to the revised Code. Secondly, further guidance will be provided regarding how the norms in the Code can be applied and accompanying governance issues will be addressed. The goal of this guidance is to shed light on where differences between the two managerial structures might lie and to indicate where companies with a one-tier board could choose their preferred option. The guidance also gives companies with a one-tier board the latitude to lay down a division of tasks between executive and non-executive directors that is appropriate for the company, within the principle of collective responsibility of management. The Committee has the impression that there is variation in the way in which the tasks are divided in practice and that it is still not sufficiently worked out in detail to fully justify a Code that is written entirely for a one-tier board.

Both the proposal for the amended principle with the accompanying best-practice provisions and the guidance are being submitted in this document to you for consultation.

The text in this consultation document is based on the proposal for revision of the Code, published on 11 February 2016. The final version of the revised Code is expected to be published after the summer. If the final version of the revised Code differs from the proposal, the respective principles, the best-practice provisions and the guidance will be amended accordingly to reflect these changes.

The Committee proposes to integrate the principle and best practice provisions presented below in the revised Code. The guidance could be published in a separate document.

2. PRINCIPLE AND BEST-PRACTICE PROVISIONS

2.8 One-tier board structure

Principle

The composition and functioning of a management board comprising both executive directors and non-executive directors should be such that proper and independent supervision by the latter is ensured.

Best-practice provisions

2.8.1 The majority of the members of the board should be non-executive directors. The independence requirements laid down in best-practice provisions 2.1.6 and 2.1.7 apply to the non-executive directors.

2.8.2 The chair of the board is primarily responsible for leadership within the board and the effectiveness of the board and the committees. He or she should ensure the proper composition and functioning of the entire board.

2.8.3 The chair of the board should not also be or have been responsible for the day-to-day management of the company and should be independent within the meaning of best-practice provisions 2.1.6 and 2.1.7.

2.8.4 The committees referred to in best-practice provision 2.3.2 should be composed exclusively of non-executive directors.

2.8.5 The non-executive directors should account for the supervision conducted over the past financial year, submitting at least reports on the subjects referred to in best-practice provisions 1.1.2, 1.3.6, 1.5.4, 1.6.3, 2.1.2, 2.1.8, 2.2.2, 2.2.8, 2.3.5 and 2.4.3.

2.8.6 One of the executive directors should be appointed as the chief executive officer (CEO). The CEO should lead the day-to-day management of the company and its business. The chair should hold regular consultations with the CEO.

Explanation

As already mentioned, the current Code already deals to a limited extent with one-tier boards: Principle III.8 and best-practice provisions III.8.1 through III.8.4 address proper and independent supervision by the non-executive directors. The Committee deems it important to further clarify how the Code can be applied by companies with a one-tier board. Therefore, it proposes to make a few amendments to the principles and the best practices in the current Code.

Principle 2.8 contains a description of a one-tier board structure. The amendments made with respect to principle III.8 in the current Code are technical in nature and are not intended to be substantive. They use the terminology that was introduced into the Dutch Civil Code (*Burgerlijk Wetboek*) when the Management and Supervision Act (*Wet bestuur en toezicht*) entered into force in 2013.

Best-practice provision 2.8.1 corresponds to the wording of best-practice provision III.8.4 from the current Code. However, the intention of this provision is to clarify that the independence requirements for the supervisory board are the same as for non-executive directors. The wording of the current Code could be interpreted to mean that no single non-executive director may be dependent, while this is not the case.

A new first sentence that further clarifies the tasks of the chair of the board has been added to best-practice provision 2.8.2. The second sentence in best-practice provision 2.8.2 has been taken unchanged from III.8.2 of the current Code.

Best-practice provision 2.8.3 pertains to the specific independence requirements that apply for the chair of the board. The first part of this best-practice provision has been taken unchanged from best practice provision III.8.1 of the current Code. Additionally, a clause was inserted that all independence requirements apply to the chair. As a result of this addition, the independence requirements that apply to the chair of the board in a one-tier board are the same as those that apply to the chair of the supervisory board in a company with a two-tier board.

Best-practice provision 2.8.4 addresses the composition of committees and has been taken unchanged from best-practice provision III.8.3 of the current Code.

Best-practice provision 2.8.5 is new. Pursuant to this provision, non-executive directors of a one-tier board must account for the fulfilment of the tasks assigned to them. The wording of this best-practice provision corresponds to the text of draft best-practice provision 2.3.11 in the proposal for the revision, which lists the provisions that prescribe the rendering of account in the report of the supervisory board. Companies are free to choose where this explanation is given: in a separate report of non-executive directors (letter of the Chairman) or in the management report. In practice, both variations occur in companies with a one-tier board.

Best-practice provision 2.8.6 is also new. In addition to a description of the tasks of the chair, it has also been proposed to explain that the CEO should lead the day-to-day management of the company and its affiliated enterprise. As a result, principle 2.8 is further elaborated upon.

The best practice provisions mentioned here, which are considered to be 'high level' by nature, are further described based on the guidance presented below.

3. GUIDANCE

This guidance further elaborates on the way in which the principles and best practice provisions of the Code can be applied by companies with a one-tier board.

1. Collective responsibility and the division of tasks

The one-tier board is composed of executive and non-executive directors. Executive directors are responsible for conducting the day-to-day management of the company. Non-executive directors are responsible for supervising this. Executive and non-executive directors are part of the same corporate body. In other words, they are all directors. The principle of collective responsibility applies to the one-tier board: the board is jointly responsible for performing the management tasks. As such, the task of non-executive directors is broader than that of supervisory board members in a two-tier system. However, the exact division of tasks between executive and non-executive directors can largely be laid down in the articles of association of the company or in board terms of reference. Such a division of tasks can be a factor in the context of individual liability and exoneration of board members according to Section 2:9, subsection 2, of the Dutch Civil Code.

Pursuant to Section 2:129a of the Dutch Civil Code, non-executive directors may in the division of tasks not be deprived of the task of supervision. Dutch law provides a few examples of tasks that may not be taken away from non-executive directors. This raises the question of how the principle of collective responsibility and the division of tasks can be translated to the Code.

1.1 Tasks of non-executive directors

- **Supervision:** according to Dutch law, the task of supervision lies with the non-executive directors. This means that, where the Code assigns a supervisory role to the supervisory board, this can be interpreted as assigning tasks to non-executive directors.
- **Tasks of the chair:** tasks that are specifically assigned to the chair of the supervisory board in the Code lie with the chair of the board in a company with a one-tier board. Examples include draft best-practice provisions 2.3.6 and 2.4.2.
- **Committees:** draft best-practice provision 2.8.4 stipulates that committees may only be composed of non-executive directors. Accordingly, tasks and responsibilities assigned to committees in the Code automatically belong to non-executive directors in companies with a one-tier board.
- **Remuneration:** pursuant to Section 2:129a, subsection 1, of the Dutch Civil Code, executive directors may not be assigned the task of determining the remuneration for executive directors. Pursuant to subsection 2 of Section 2:129a of the Dutch Civil Code, executive directors do not take part in the discussion and decision-taking with respect to determining the remuneration for executive directors. As a result, the tasks pertaining to remuneration that have been assigned to the supervisory board in the draft of Chapter 3 in the proposal for revision belong to the non-executive directors.
- **Nomination for the appointment of directors:** pursuant to Section 2:129a, subsection 1, of the Dutch Civil Code, executive directors may not be assigned the task of nominating executive directors for appointment. As a result, the tasks in draft principle 2.2 and the subsequent best-practice provisions that are related to appointment and succession planning belong to non-executive directors. The same applies for the responsibility of drawing up a profile of board members (2.1.1) and policy regarding board diversity (2.1.5).

1.2 Tasks of executive directors

Certain tasks in the Code are more executive in nature. In the articles of association, these can be assigned to one or more executive directors. One example is the task laid down in draft best-practice provision 1.7.1, which pertains to the provision of information to the external auditor. Executive tasks pertaining to risk management laid down in draft best-practice provisions 1.2.1 to 1.2.3 may also serve as a potential example.

1.3 Collective responsibility

For the remaining tasks, the principle of collective responsibility can remain as is. Where the Code assigned tasks and responsibilities to the board in a two-tier system, non-executive directors in a one-tier board structure are jointly responsible. This does not impact the possibility of dividing the tasks in accordance with the articles of association.

2. Approval by the majority of non-executive directors

In a number of places in the proposal for revision of the Code, it is stipulated that the approval of the supervisory board is required. Under Dutch law, the one-tier board constitutes a single corporate body in which there is a division of tasks between executive and non-executive directors. As a general rule, decision-making within this corporate body requires a majority of votes, regardless whether these votes come from executive or non-executive directors. Decision-making can also be assigned to either executive or non-executive directors via the division of tasks.

Regarding certain parts of the proposal for revision of the Code that are closely connected with the supervisory task, it is conceivable – in addition to the aforementioned – that the decision-making be assigned to the non-executive directors instead of the entire board. In these instances, an arrangement can be chosen that is similar to Section 2:164a of the Dutch Civil Code, which provides that the decision concerned requires approval of the majority of non-executive directors. In this way, (independent) supervision within the board, as constituted by the one-tier board, remains ensured.

The following draft principles and best-practice provisions are conceivable in this context:

- 1.1.2 approval of the strategy and explanation of it;
- 1.6 decision to nominate an external auditor;
- 2.3.10 approval of the dismissal of the company secretary;
- 2.4.1 approval of the acceptance of additional positions by executive directors;
- 2.6.2 decision on whether there is a conflict of interest;
- 2.6.3 decision to enter into transactions with a conflict of interest;
- 2.6.4 transactions between companies and shareholders > 10%;
- 2.6.5 approval of personal loans to directors.

It is the decision of the company as to whether or not the approval should be granted in the absence of executive directors, as long as due care in the decision-making process remains ensured.

3. Committees

3.1 Composition and establishment of committees

In order to enable effective supervision, the audit committee, remuneration committee and the selection and appointment committee should be composed entirely of non-executive directors, as laid down in draft best-practice provision 2.8.4. The Committee is aware of the fact that the British and Belgian Corporate Governance Codes also permit executive directors to be a member of the selection and appointment committee, as long as the majority consists of non-executive directors. However, such a provision would not be in keeping with the Dutch approach with respect to independence requirements of committee members.

It seems logical that the committees are established by non-executive directors, given that they consist entirely of non-executive directors. In accordance with draft best practice provision 2.3.4, the chair of a one-tier board cannot simultaneously act as chair of one of the committees.

3.2 Committee reports

Even though committees are entirely composed of non-executive directors, the choice is left up to one-tier boards whether these committees report to the entire board or only to the non-executive directors. In practice, both variations seem to exist. It is important that thought is given to the best set-up for the reporting lines of committees and that an efficient working method is chosen. This pertains, for example, to draft best-practice provisions 2.3.5 (committees report on the discussion and the findings) and 1.5.3 (report from the audit committee) of the proposal for revision.

4. Rendering of account by non-executive directors

By law, companies are only obliged to draw up a management report (Section 2:391 of the Dutch Civil Code). The report of the supervisory board is discussed at various instances in both the current Code and the proposal for revision. The translation from a two-tier board to a one-tier board raises the question of whether it should be stipulated that non-executive directors, who are also members of the board, have to draw up their own separate report in addition to the statutorily required management report. After all, as members of the board, the non-executive directors are, already co-responsible for drawing up the annual report.

In practice, Dutch companies which already have a one-tier board apply both options: some non-executive directors draw up a separate report that is included in the annual accounts, while others deem one integrated report sufficient. Apart from such technicalities, the main point of focus is to ensure that the account that is rendered by non-executive directors in a one-tier board is also accessible and transparent.

For this reason, draft best-practice provision 2.8.5 does not elaborate on the way in which account is rendered with respect to tasks that have been assigned to non-executive directors, as described in draft-best-practice provision 2.3.11. In the management report, the one-tier board can devote attention to the fulfilment of the supervisory activities over the past financial year, without a separate report having to be drawn up. It is possible to draw a parallel here with corporate governance practices in England, where non-executive directors mainly report through the audit, nomination and remuneration committees. It is also conceivable for the annual report to include a letter from the chair, in which the non-executive directors render account. In this way, the executive responsibilities can be separated from the supervisory tasks.

5. Effective management and supervision

5.1 Board profile

The current Code stipulates in best-practice provision III.3.1 that the supervisory board should draw up a profile regarding its size and composition, taking into account the nature of the enterprise, its activities and the desired expertise and background of the commissioners. The profile is referred to in a number of best-practice provisions in the current Code. The proposal for revision of the current Code also provides for the drawing up of a board profile, for example in draft best-practice provision 2.1.1. This provision stipulates that the supervisory board should draw up a profile, taking into account the nature and activities of the company and its business. The profile is also relevant to the supervisory board, both with respect to the appointment and reappointment of commissioners, on the one hand, and the process of succession planning, on the other, according to draft best-practice provisions 2.2.2 and 2.2.4.

For companies with a one-tier board, the task of drawing up a profile falls within the responsibilities of the non-executive directors. The profile defines requirements relating to expertise, independence and composition, in the context of the supervisory role. As such, it goes without saying that the profile only pertains to non-executive directors. Naturally, the company could draw up a profile for executive directors as well.

5.2 Period of appointment

In the proposal for revision, draft best-practice provisions 2.2.1 and 2.2.2 address the period of appointment concerning directors and commissioners. Both draft best-practice provisions can be applied in the same way with respect to executive and non-executive directors.

5.3 Evaluation

In the proposal for revision of the Code, draft best-practice provisions 2.2.6, 2.2.7 and 2.2.8 address the evaluation of the functioning of the executive board and the supervisory board and the account to be rendered in this respect. These provisions stipulate that the supervisory board should evaluate its own functioning and the functioning of the executive board, both collectively and with regard to individual members. The board also evaluates itself.
A similar evaluation process for companies with a one-tier board is not appropriate in all cases. After all, a one-tier board is composed of both executive and non-executive directors. Accordingly, the choice is left up to companies with a one-tier board regarding how they perform the evaluation of their functioning. One possibility is for non-executive directors to perform an evaluation of their own functioning as well as the functioning of the board as a whole and that of individual directors. The choice of how the evaluation is performed also determines whether account is to be rendered by either the supervisory or the management board, based on draft best-practice provision 2.2.8.

5.4 Terms of reference

The proposal for revision addresses the terms of reference of the supervisory board in draft best-practice provisions 2.3.1 and 2.6.1, for instance with respect to the division of tasks among members and the way in which conflicts of interests should be prevented. For listed companies featuring a one-tier board, such terms of reference apply to the entire board. This approach fits with the joint responsibility of the board for performing the managerial tasks.

5.5 Culture

A healthy corporate culture is a key requirement for long-term value creation. For this reason, draft principle 2.5 and the subsequent best-practice provisions of the proposal for revision state that the board is responsible for implementing such a culture in the company and its business.

In applying the Code, attributing responsibility for embedding culture within the company (draft best-practice provision 2.5.3) is less straightforward for companies with a one-tier board. The aspect of culture, however, is relevant to such a great extent that it would seem logical to assign responsibility for its embedding to the entire one-tier board.

5.6 Takeover situations

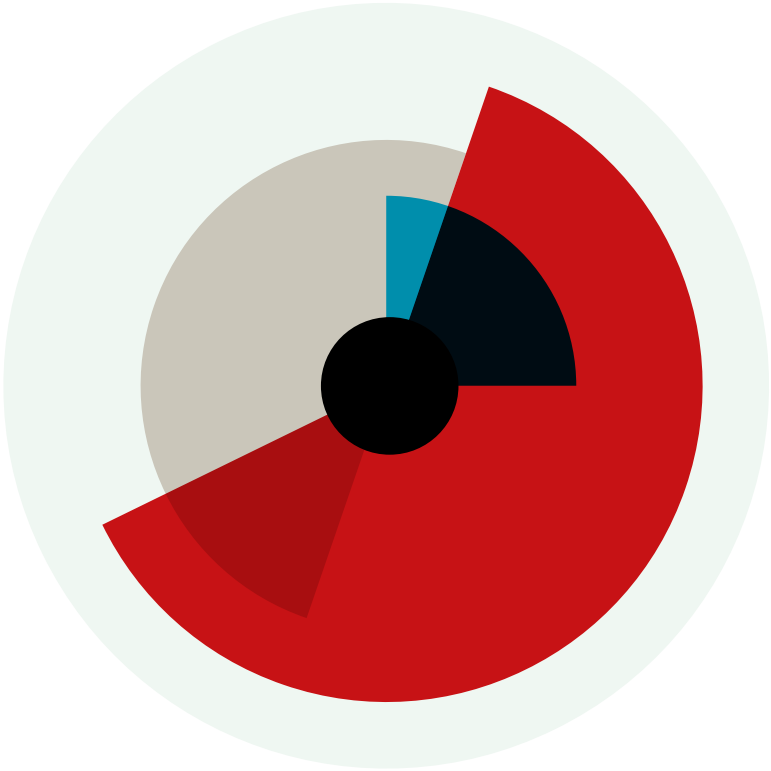
The proposal for revision addresses takeover situations in draft principle 2.7 and the accompanying best-practice provisions. Takeovers can put companies in a complicated position, which require that particular attention be devoted to adequate information provision, a careful weighing of interests, independence and the prevention of conflicts of interest.

One of the advantages mentioned with respect to a one-tier board is that non-executive directors would be able to receive more information sooner regarding the envisioned decision-making in complicated situations, and would also be more capable of maintaining supervision.[4] This is without prejudice to the fact that the draft principle and the best-practice provisions addressed here are equally relevant for companies with a one-tier board.

6. Remuneration

In addition to the matters already addressed in Section 1.1 regarding specific tasks of non-executive directors with respect to remuneration, some aspects could be clarified further. First, the draft best-practice provisions that pertain to severance pay (3.2.3) and publication of the contract of directors (3.4.2) only apply to the severance payments to and contracts of executive directors. Draft principle 3.3 and the accompanying draft best-practice provisions with respect to remuneration of the supervisory board naturally pertain only to the remuneration of non-executive directors.

4 *Dutch House of Lords Parliamentary Papers* 2010/11, 31 763, C, 3.



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