

**COMMISSION RECOMMENDATION****of 15 February 2005****on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board****(Text with EEA relevance)**

(2005/162/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the second indent of Article 211 thereof,

Whereas:

(1) In a Communication adopted on 21 May 2003, the Commission presented its Action Plan 'Modernising Company Law and Enhancing Corporate Governance in the European Union — A Plan to Move Forward' <sup>(1)</sup>. The main objectives of the Action Plan are to strengthen shareholders' rights and protection for employees, creditors and the other parties with which companies deal, while adapting company law and corporate governance rules appropriately for different categories of company, and to foster the efficiency and competitiveness of businesses, with special attention to some specific cross-border issues.

(2) In its Resolution of 21 April 2004, the European Parliament welcomed the Action Plan and expressed strong support for most of the initiatives announced. The European Parliament called on the Commission to propose rules to eliminate and prevent conflicts of interest, and stressed in particular the need for listed companies to have an audit committee, whose functions should include overseeing the external auditor's independence, objectivity and effectiveness.

(3) Non-executive or supervisory directors are recruited by companies for a variety of purposes. Of particular importance is their role in overseeing executive or managing directors and dealing with situations involving conflicts of interests. It is vital to foster that role in order to restore confidence in financial markets. Member States should therefore be invited to adopt measures which would be applicable to listed companies, defined as companies whose securities are

admitted to trading on a regulated market in the Community. When implementing this Recommendation, Member States should consider the specificities of collective investment undertakings of the corporate type and prevent the various types of collective investment undertaking from being subjected, unnecessarily, to unequal treatment. As regards collective investment undertakings as defined in Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) <sup>(2)</sup>, that Directive already provides for a set of specific governance mechanisms. However, in order to prevent the unnecessarily unequal treatment of those collective investment undertakings of the corporate type not subject to harmonisation at Community level, Member States should take into account whether and to what extent these non-harmonised collective investment undertakings are subject to equivalent governance mechanisms.

(4) In view of the complexity of many of the issues at stake, the adoption of detailed binding rules is not necessarily the most desirable and efficient way of achieving the objectives pursued. Many corporate governance codes adopted in Member States tend to rely on disclosure to encourage compliance, based on the 'comply or explain' approach: companies are invited to disclose whether they comply with the code and to explain any material departures from it. This approach enables companies to reflect sector- and enterprise-specific requirements, and the markets to assess the explanations and justifications provided. With a view to fostering the role of non-executive or supervisory directors, it is therefore appropriate that all Member States be invited to take the steps necessary to introduce at national level a set of provisions based on the principles set out in this Recommendation, to be used by listed companies either on the basis of the 'comply or explain' approach or pursuant to legislation.

(5) If Member States decide to use the 'comply or explain' approach (whereby companies are required to explain their practices by reference to a set of designated best practice recommendations), they should be free to do so on the basis of relevant recommendations developed by market participants.

<sup>(1)</sup> COM(2003) 284 final.

<sup>(2)</sup> OJ L 375, 31.12.1985, p. 3. Directive as last amended by Directive 2004/39/EC of the European Parliament and of the Council (OJ L 145, 30.4.2004, p. 1).

- (6) Any measures adopted by Member States in line with this Recommendation should aim fundamentally at improving the corporate governance of listed companies. Since that objective is relevant to the protection of investors, actual or potential, in all companies listed in the Community, whether or not they are incorporated in one of the Member States, the measures should also cover companies incorporated in third countries but listed in the Community.
- (7) The presence of independent representatives on the board, capable of challenging the decisions of management, is widely considered as a means of protecting the interests of shareholders and other stakeholders. In companies with a dispersed ownership, the primary concern is how to make managers accountable to weak shareholders. In companies with controlling shareholders, the focus is more on how to make sure that the company will be run in a way that sufficiently takes into account the interests of minority shareholders. Ensuring adequate protection for third parties is relevant in both cases. Whatever the formal board structure of a company, the management function should therefore be subject to an effective and sufficiently independent supervisory function. Independence should be understood as the absence of any material conflict of interest; in this context, proper attention should be paid namely to any threats which might arise from the fact that a representative on the board has close ties with a competitor of the company.
- (8) In order to ensure that the management function will be submitted to an effective and sufficiently independent supervisory function, the (supervisory) board should comprise a sufficient number of committed non-executive or supervisory directors, who play no role in the management of the company or its group and who are independent in that they are free of any material conflict of interest. In view of the different legal systems existing in Member States, the proportion of (supervisory) board members to be made up of independent directors should not be defined precisely at Community level.
- (9) The supervisory role of non-executive or supervisory directors is commonly perceived as crucial in three areas, where the potential for conflict of interest of management is particularly high, especially when such matters are not a direct responsibility for shareholders: nomination of directors, remuneration of directors, and audit. It is therefore appropriate to foster the role of non-executive or supervisory directors in these areas and to encourage the creation within the (supervisory) board of committees responsible respectively for nomination, remuneration and audit.
- (10) In principle, and without prejudice to the powers of the general meeting, only the (supervisory) board as a whole has statutory decision-making authority and, as a collegiate body, is collectively accountable for the performance of its duties. The (supervisory) board has the power to determine the number and structure of the committees which it deems to be appropriate to facilitate its own work, but these committees are in principle not to be a substitute for the (supervisory) board itself. As a general rule, therefore, the nomination, remuneration and audit committees should make recommendations aimed at preparing the decisions to be taken by the (supervisory) board. However, the (supervisory) board should not be precluded from delegating part of its decision-making powers to committees when it considers it appropriate and when this is permissible under national law, even though the (supervisory) board remains fully responsible for the decisions taken in its field of competence.
- (11) Since the identification of candidates to fill unitary or dual board vacancies raises issues relevant to the selection of non-executive or supervisory directors who are to oversee management or relevant to the continuation in office of management, the nomination committee should be composed mainly of independent non-executive or supervisory directors. That would leave room on the nomination committee for non-executive or supervisory directors who do not meet the independence criteria. It would also leave room for executive/managing directors (in companies where the nomination committee is created within the unitary board and as long as executive/managing directors do not form a majority on that committee).
- (12) Given the different approaches in the Member States with respect to the bodies responsible for appointing and removing directors, the role of a nomination committee created within the (supervisory) board should essentially be to make sure that, where the (supervisory) board plays a role in the appointment and removal process (either through a power to table proposals or to make decisions, as defined by national law), this role is performed in as objective and professional a way as possible. The nomination committee should therefore essentially make recommendations to the (supervisory) board with respect to the appointment and removal of directors by the body competent under national company law.

- (13) In the area of remuneration, corporate governance codes adopted in Member States tend to focus primarily on the remuneration of executive or managing directors, since the potential for abuse and conflicts of interest is essentially located there. Many codes also recognise that some consideration should be given at board level to the remuneration policy for senior management. Finally, the issue of stock options is granted special attention. Given the different approaches in the Member States with respect to the bodies responsible for setting the remuneration of directors, the role of a remuneration committee created within the (supervisory) board should essentially be to make sure that, where the (supervisory) board plays a role in the remuneration setting process (either through a power to table proposals or to make decisions, as defined by national law), this role is performed in as objective and professional a way as possible. The remuneration committee should therefore essentially make recommendations to the (supervisory) board with respect to those remuneration issues for decision by the body competent under national company law.
- (14) Two key responsibilities of the (supervisory) board seem to ensure that the financial reports and other related information disseminated by the company present an accurate and complete picture of the company's position and to monitor the procedures established for the evaluation and management of risks. In this context, most corporate governance codes assign to the audit committee an essential role in assisting the (supervisory) board to fulfil these duties. In some Member States, such responsibilities are attributed, wholly or partly, to corporate bodies external to the (supervisory) board. It is therefore appropriate to provide that an audit committee created within the (supervisory) board should, as a general rule, make recommendations to the (supervisory) board with respect to those audit issues, and that such functions may be performed by other structures — external to the (supervisory) board — which would be equally effective.
- (15) In order for non-executive or supervisory directors to play an effective role, they should have the right background and sufficient time for the job. In addition, a sufficient number of them should meet appropriate independence criteria. Before the appointment of non-executive or supervisory directors, adequate information should be provided on these issues and that information should be updated with sufficient frequency.
- (16) With respect to the qualifications of directors, most corporate governance codes insist on the need to have qualified individuals on the board, but at the same time recognise that the definition of what constitutes proper qualifications should be left to the company itself, because such qualifications will depend, *inter alia*, on its activities, size and environment and because they should be met by the board as a whole. There is nevertheless one issue which usually raises particular concern, namely the need for particular competence in the audit committee where some specific knowledge is deemed to be indispensable. The (supervisory) board should therefore determine the desired composition of the audit committee and evaluate it periodically, devoting specific attention to the experience necessary in that committee.
- (17) With respect to the commitment of directors, most corporate governance codes seek to make sure that directors devote sufficient time to their duties. Some of these codes limit the number of directorships that may be held in other companies: the positions of chairman or of executive or managing director are usually recognised as more demanding than those of non-executive or supervisory director, but the precise numbers of other directorships acceptable vary widely. However, the involvement required from a director may vary widely depending on the company and its environment; in such a situation, each director should undertake to strike a proper balance between his various engagements.
- (18) Generally, corporate governance codes adopted in the Member States recognise the need for a significant proportion of non-executive or supervisory directors to be independent, that is to say, free of any material conflict of interest. Independence is most often understood as the absence of close ties with management, controlling shareholders or the company itself. In the absence of any common understanding of what independence precisely entails, it is appropriate to provide a general statement describing what the general objective is. Provision should also be made to cover a (non-exhaustive) number of situations, involving the relationships or circumstances usually recognised as likely to generate a material conflict of interest, which Member States must duly consider when introducing at national level the criteria to be used by the (supervisory) board. The determination of what constitutes independence should principally be an issue for the (supervisory) board itself to determine. When the (supervisory) board applies the independence criteria, it should focus on substance rather than form.
- (19) In view of the importance attaching to the role of non-executive or supervisory directors with respect to the restoration of confidence, and more generally to the development of sound corporate governance practices, the steps taken for the implementation of this Recommendation in Member States should be monitored closely,

HEREBY RECOMMENDS:

## SECTION I

### SCOPE AND DEFINITIONS

#### 1. Scope

- 1.1. Member States are invited to take the steps necessary to introduce, at national level, a set of provisions concerning the role of non-executive or supervisory directors and the committees of the (supervisory) board to be used by listed companies, either through a 'comply or explain' approach or through legislation, and with the instruments best suited to their legal environment.

They should take due account of the specificities of collective investment undertakings of the corporate type, as covered by Directive 85/611/EEC. Member States should also consider the specificities of collective investment undertakings of the corporate type which are not covered by that Directive and the sole purpose of which is to invest money raised from investors in a diversified range of assets and which do not seek to take legal or management control over any of the issuers of their underlying investments.

- 1.2. If Member States decide to use the 'comply or explain' approach, whereby companies are required to explain their practices by reference to a set of designated best practice recommendations, they should require companies to specify annually the recommendations with which they have not complied (and, in the case of recommendations whose requirements are of a continuing nature, for what part of the accounting period such non-compliance occurred), and explain in a substantial and specific manner the extent of, and the reasons for, any material non-compliance.
- 1.3. In their consideration of the principles set out in this Recommendation, Member States should, in particular, take into account the following:
- 1.3.1. the functions and characteristics assigned by Member States to any of the committees created within the (supervisory) board and proposed in this Recommendation should duly take into account the rights and duties of relevant corporate bodies as defined under national law;

- 1.3.2. Member States should be allowed to choose, in whole or in part, between the creation within the (supervisory) board of any of the committees with the characteristics advocated in this Recommendation, and the use of other structures — external to the (supervisory) board — or procedures. Such structures or procedures, which could be either mandatory for companies under national law or best practice recommended at national level through a 'comply or explain' approach, should be functionally equivalent and equally effective.

- 1.4. With respect to listed companies incorporated in one of the Member States, the set of provisions to be introduced by Member States should cover at least those listed companies which are incorporated within their territory.

With respect to listed companies not incorporated in one of the Member States, the set of provisions to be introduced by Member States should cover at least those listed companies which have their primary listing on a regulated market established in their territory.

#### 2. Definitions for the purposes of this Recommendation

- 2.1. 'Listed companies' means companies whose securities are admitted to trading on a regulated market, within the meaning of Directive 2004/39/EC, in one or more Member States.
- 2.2. 'Director' means any member of any administrative, managerial or supervisory body of a company.
- 2.3. 'Executive director' means any member of the administrative body (unitary board) who is engaged in the daily management of the company.
- 2.4. 'Non-executive director' means any member of the administrative body (unitary board) of a company other than an executive director.
- 2.5. 'Managing director' means any member of the managerial body (dual board) of a company.
- 2.6. 'Supervisory director' means any member of the supervisory body (dual board) of a company.

## SECTION II

### PRESENCE AND ROLE OF NON-EXECUTIVE OR SUPERVISORY DIRECTORS ON (SUPERVISORY) BOARDS

#### 3. Presence of non-executive or supervisory directors

3.1. The administrative, managerial and supervisory bodies should include in total an appropriate balance of executive/managing and non-executive/supervisory directors such that no individual or small group of individuals can dominate decision-making on the part of these bodies.

3.2. The present or past executive responsibilities of the (supervisory) board's chairman should not stand in the way of his ability to exercise objective supervision. On a unitary board, one way to ensure this is that the roles of chairman and chief executive are separate; in the case of unitary and dual boards, one option may be that the chief executive does not immediately become the chairman of the (supervisory) board. In cases where a company chooses to combine the roles of chairman and chief executive or to immediately appoint as chairman of the (supervisory) board the former chief executive, this should be accompanied with information on any safeguards put in place.

#### 4. Number of independent directors

A sufficient number of independent non-executive or supervisory directors should be elected to the (supervisory) board of companies to ensure that any material conflict of interest involving directors will be properly dealt with.

#### 5. Organisation in board committees

Boards should be organised in such a way that a sufficient number of independent non-executive or supervisory directors play an effective role in key areas where the potential for conflict of interest is particularly high. To this end, but subject to point 7, nomination, remuneration and audit committees should be created within the (supervisory) board, where that board plays a role in the areas of nomination, remuneration and audit under national law, taking into account Annex I.

#### 6. Role of the committees vis-à-vis the (supervisory) board

6.1. The nomination, remuneration and audit committees should make recommendations aimed at preparing

the decisions to be taken by the (supervisory) board itself. The primary purpose of the committees should be to increase the efficiency of the (supervisory) board by making sure that decisions are based on due consideration, and to help organise its work with a view to ensuring that the decisions it takes are free of material conflicts of interest. The creation of the committees is not intended, in principle, to remove the matters considered from the purview of the (supervisory) board itself, which remains fully responsible for the decisions taken in its field of competence.

6.2. The terms of reference of any committee created should be drawn up by the (supervisory) board. Where permissible under national law, any delegation of decision-making power should be explicitly declared, properly described and made public in a fully transparent way.

#### 7. Flexibility in setting up the committees

7.1. Companies should make sure that the functions assigned to the nomination, remuneration and audit committees are carried out. However, companies may group the functions as they see fit and create fewer than three committees. In such a situation, companies should give a clear explanation both of the reasons why they have chosen an alternative approach and how the approach chosen meets the objective set for the three separate committees.

7.2. In companies where the (supervisory) board is small, the functions assigned to the three committees may be performed by the (supervisory) board as a whole, provided that it meets the composition requirements advocated for the committees and that adequate information is provided in this respect. In such a situation, the national provisions relating to board committees (in particular with respect to their role, operation, and transparency) should apply, where relevant, to the (supervisory) board as a whole.

#### 8. Evaluation of the (supervisory) board

Every year, the (supervisory) board should carry out an evaluation of its performance. This should encompass an assessment of its membership, organisation and operation as a group, an evaluation of the competence and effectiveness of each board member and of the board committees, and an assessment of how well the board has performed against any performance objectives which have been set.

## 9. **Transparency and communication**

- 9.1. The (supervisory) board should make public at least once a year (as part of the information disclosed by the company annually on its corporate governance structures and practices) adequate information about its internal organisation and the procedures applicable to its activities, including an indication of the extent to which the self-evaluation performed by the (supervisory) board has led to any material change.
- 9.2. The (supervisory) board should ensure that shareholders are properly informed as regards the affairs of the company, its strategic approach, and the management of risks and conflicts of interest. The roles of directors regarding communication and engagement with shareholders should be clearly delineated.

### SECTION III

#### PROFILE OF NON-EXECUTIVE OR SUPERVISORY DIRECTORS

## 10. **Appointment and removal**

Non-executive or supervisory directors should be appointed for specified terms subject to individual re-election, at maximum intervals to be determined at national level with a view to enabling both the necessary development of experience and sufficiently frequent reconfirmation of their position. It should also be possible to remove them, but their removal should not be easier than for an executive or managing director.

## 11. **Qualifications**

- 11.1. In order to maintain a proper balance in terms of the qualifications possessed by its members, the (supervisory) board should determine its desired composition in relation to the company's structure and activities, and evaluate it periodically. The (supervisory) board should ensure that it is composed of members who, as a whole, have the required diversity of knowledge, judgement and experience to complete their tasks properly.
- 11.2. The members of the audit committee, should, collectively, have a recent and relevant background in and experience of finance and accounting for listed companies appropriate to the company's activities.
- 11.3. All new members of the (supervisory) board should be offered a tailored induction programme covering to the extent necessary their responsibilities and the

company's organisation and activities. The (supervisory) board should conduct an annual review to identify areas where directors need to update their skills and knowledge.

- 11.4. When the appointment of a director is proposed, disclosure should be made of his particular competences which are relevant to his service on the (supervisory) board. To enable markets and the public to assess whether these competences remain appropriate over time, the (supervisory) board should disclose every year a profile of the board's composition and information on the particular competences of individual directors which are relevant to their service on the (supervisory) board.

## 12. **Commitment**

- 12.1. Each director should devote to his duties the necessary time and attention, and should undertake to limit the number of his other professional commitments (in particular any directorships held in other companies) to such an extent that the proper performance of his duties is assured.
- 12.2. Where the appointment of a director is proposed, his other significant professional commitments should be disclosed. The board should be informed of subsequent changes. Every year, the board should collect data on such commitments, and make the information available in its annual report.

## 13. **Independence**

- 13.1. A director should be considered to be independent only if he is free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement.
- 13.2. A number of criteria for assessment of the independence of directors should be adopted at national level, taking into account the guidance set out in Annex II, which identifies a number of situations reflecting the relationships or circumstances usually recognised as likely to generate material conflict of interest. The determination of what constitutes independence is fundamentally an issue for the (supervisory) board itself to determine. The (supervisory) board may consider that, although a particular director meets all the criteria laid down at national level for assessment of the independence of directors, he cannot be considered independent owing to the specific circumstances of the person or the company, and the converse also applies.

13.3. Proper information should be disclosed on the conclusions reached by the (supervisory) board in its determination of whether a particular director should be regarded as independent.

13.3.1. When the appointment of a non-executive or supervisory director is proposed, the company should disclose whether it considers him to be independent; if one or more of the criteria laid down at national level for assessment of independence of directors is not met, the company should disclose its reasons for nevertheless considering that director to be independent. Companies should also disclose annually which directors they consider to be independent.

13.3.2. If one or more of the criteria laid down at national level for assessment of independence of directors has not been met throughout the year, the company should disclose its reasons for considering that director to be independent. To ensure the accuracy of the information provided on the independence of directors, the company should require the independent directors to have their independence periodically re-confirmed.

#### SECTION IV FINAL PROVISIONS

##### 14. Follow-up

Member States are invited to take the necessary measures to promote the application, by 30 June 2006, of the principles set out in this Recommendation and to notify the Commission of the measures taken in accordance with this Recommendation, in order to enable the Commission to monitor closely the situation and, on that basis, to assess the need for further measures.

##### 15. Addressees

This Recommendation is addressed to the Member States.

Done at Brussels, 15 February 2005.

*For the Commission*  
Charlie McCREEVY  
*Member of the Commission*

---

The following Annexes provide additional guidance for the interpretation of the principles set out in the Recommendation.

## ANNEX I

**Committees of the (supervisory) board**

## 1. COMMON FEATURES

1.1. *Size*

When committees are created within the (supervisory) board, they should normally be composed of at least three members. In companies with small (supervisory) boards, they could exceptionally be composed of two members only.

1.2. *Composition*

Chairmanship and membership of the committees should be decided with due regard to the need to ensure that committee membership is refreshed and that undue reliance is not placed on particular individuals.

1.3. *Terms of reference*

The exact mandate of each committee created should be described in the terms of reference drawn up by the (supervisory) board.

1.4. *Available resources*

Companies should ensure that committees are provided with sufficient resources to discharge their duties, which includes the right to obtain — in particular from officers of the company — all the necessary information or to seek independent professional advice on issues falling in their area of competence.

1.5. *Attendance at committee meetings*

With a view to ensuring the autonomy and objectivity of the committees, directors other than the committee members should normally be entitled to attend its meetings only at the invitation of the committee. The committee may invite or require certain officers or experts to attend.

1.6. *Transparency*

1. Committees should discharge their duties within the set terms of reference, and ensure that they regularly report to the (supervisory) board about their activities and results.
2. The terms of reference set for any committee created, explaining its role and any authority delegated to it by the (supervisory) board where permissible under national law, should be made public at least once a year (as part of the information disclosed by the company annually on its corporate governance structures and practices). Companies should also make public annually a statement by existing committees about their membership, the number of their meetings and attendance over the year, and their main activities. In particular, the audit committee should confirm that it is satisfied with the independence of the audit process and describe briefly the steps it has taken to reach this conclusion.
3. The chairman of each committee should be able to communicate directly with shareholders. The circumstances in which this should happen should be spelled out in the committee's terms of reference.

## 2. THE NOMINATION COMMITTEE

2.1. *Creation and composition*

1. Where, under national law, the (supervisory) board is playing a role, either by making decisions itself or by making proposals for consideration by another corporate body, in the process for appointment and/or removal of directors, a nomination committee should be set up within the (supervisory) board.
2. The nomination committee should be composed of at least a majority of independent non-executive or supervisory directors. When a company deems it appropriate for the nomination committee to comprise a minority of non-independent members, the Chief Executive Officer could be a member of such a committee.



## 2.2. Role

### 1. The nomination committee should at least:

- identify and recommend, for the approval of the (supervisory) board, candidates to fill board vacancies as and when they arise. In doing so, the nomination committee should evaluate the balance of skills, knowledge and experience on the board, prepare a description of the roles and capabilities required for a particular appointment, and assess the time commitment expected,
- periodically assess the structure, size, composition and performance of the unitary or dual board, and make recommendations to the (supervisory) board with regard to any changes,
- periodically assess the skills, knowledge and experience of individual directors, and report on this to the (supervisory) board,
- properly consider issues related to succession planning.

### 2. In addition, the nomination committee should review the policy of the (management) board for selection and appointment of senior management.

## 2.3. Operation

1. The nomination committee should consider proposals made by relevant parties, including management and shareholders<sup>(1)</sup>. In particular, the Chief Executive Officer should be adequately consulted by, and entitled to submit proposals to the nomination committee, especially when dealing with issues related to executive/managing directors or senior management.
2. In performing its duties, the nomination committee should be able to use any forms of resources it deems appropriate, including external advice or advertising, and should receive appropriate funding from the company to this effect.

## 3. THE REMUNERATION COMMITTEE

### 3.1. Creation and composition

1. Where, under national law, the (supervisory) board is playing a role, either by making decisions itself or by making proposals for consideration by another corporate body, in the process for setting remuneration of directors, a remuneration committee should be set up within the (supervisory) board.
2. The remuneration committee should be composed exclusively of non-executive or supervisory directors. At least a majority of its members should be independent.

### 3.2. Role

#### 1. With respect to executive or managing directors, the committee should at least:

- make proposals, for the approval of the (supervisory) board, on the remuneration policy for executive or managing directors. Such policy should address all forms of compensation, including in particular the fixed remuneration, performance-related remuneration schemes, pension arrangements, and termination payments. Proposals related to performance-related remuneration schemes should be accompanied with recommendations on the related objectives and evaluation criteria, with a view to properly aligning the pay of executive or managing directors with the long-term interests of the shareholders and the objectives set by the (supervisory) board for the company,

<sup>(1)</sup> When proposals are submitted by shareholders for the consideration of the nomination committee and the latter decides not to recommend these candidates for the approval of the (supervisory) board, this does not prevent shareholders from proposing the same candidates directly to the general meeting when they have the right to table draft resolutions to this effect under national law.

- make proposals to the (supervisory) board on the individual remuneration to be attributed to executive or managing directors, ensuring that they are consistent with the remuneration policy adopted by the company and the evaluation of the performance of the directors concerned. In doing so, the committee should be properly informed as to the total compensation obtained by the directors from other companies affiliated to the group,
  - make proposals to the (supervisory) board on suitable forms of contract for executive or managing directors,
  - assist the (supervisory) board in overseeing the process whereby the company complies with existing provisions regarding disclosure of remuneration-related items (in particular the remuneration policy applied and the individual remuneration attributed to directors).
2. With respect to senior management (as defined by the (supervisory) board), the committee should at least:
- make general recommendations to the executive or managing directors on the level and structure of remuneration for senior management,
  - monitor the level and structure of remuneration for senior management, on the basis of adequate information provided by executive or managing directors.
3. With respect to stock options and other share-based incentives which may be granted to directors, managers, or other employees, the committee should at least:
- debate the general policy regarding the granting of such schemes, in particular stock options, and make any related proposals to the (supervisory) board,
  - review the information provided on this topic in the annual report and to the shareholders meeting where relevant,
  - make proposals to the (supervisory) board concerning the choice between granting options to subscribe shares or granting options to purchase shares, specifying the reasons for its choice as well as the consequences that this choice has.

### 3.3. *Operation*

1. The remuneration committee should consult at least the chairman and/or chief executive about their views relating to the remuneration of other executive or managing directors.
2. The remuneration committee should be able to avail itself of consultants, with a view to obtaining the necessary information on market standards for remuneration systems. The committee should be responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee, and should receive appropriate funding from the company to this effect.

## 4. THE AUDIT COMMITTEE

### 4.1. *Composition*

The audit committee should be composed exclusively of non-executive or supervisory directors. At least a majority of its members should be independent.

#### 4.2. Role

1. With respect to the internal policies and procedures adopted by the company, the audit committee should assist the (supervisory) board to at least:
  - monitor the integrity of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting methods used by the company and its group (including the criteria for the consolidation of the accounts of companies in the group),
  - review at least annually the internal control and risk management systems, with a view to ensuring that the main risks (including those related to compliance with existing legislation and regulations) are properly identified, managed and disclosed,
  - ensure the effectiveness of the internal audit function, in particular by making recommendations on the selection, appointment, reappointment and removal of the head of the internal audit department and on the department's budget, and by monitoring the responsiveness of management to its findings and recommendations. If the company does not have an internal audit function, the need for one should be reviewed at least annually.
2. With respect to the external auditor engaged by the company, the audit committee should at least:
  - make recommendations to the (supervisory) board in relation to the selection, appointment, reappointment and removal of the external auditor by the body competent under national company law, and to the terms and conditions of his engagement,
  - monitor the external auditor's independence and objectivity, in particular by reviewing the audit firm's compliance with applicable guidance relating to the rotation of audit partners, the level of fees paid by the company, and other related regulatory requirements,
  - keep the nature and extent of non-audit services under review, based inter alia on disclosure by the external auditor of all fees paid by the company and its group to the audit firm and network, with a view to preventing any material conflicts of interest from arising. The committee should set and apply a formal policy specifying, in accordance with the principles and guidance provided in Commission Recommendation 2002/590/EC<sup>(1)</sup>, the types of non-audit services which are (a) excluded, (b) permissible after review by the committee, and (c) permissible without referral to the committee,
  - review the effectiveness of the external audit process, and the responsiveness of management to the recommendations made in the external auditor's management letter,
  - investigate the issues giving rise to any resignation of the external auditor, and make recommendations as to any required action.

#### 4.3. Operation

1. The company should provide an induction programme for new audit committee members, and subsequent relevant training on an ongoing and timely basis. All committee members should be provided in particular with full information relating to the company's specific accounting, financial and operational features.

<sup>(1)</sup> OJ L 191, 19.7.2002, p. 22.

2. The management should inform the audit committee of the methods used to account for significant and unusual transactions where the accounting treatment may be open to different approaches. In this respect, particular attention should be paid to both the existence of, and the justification for, any activity carried out by the company in offshore centres and/or through special purpose vehicles.
  3. The audit committee shall decide whether and, if so, when the chief executive officer or chairman of the managing board, the chief financial officer (or senior employees responsible for finance, accounting, and treasury matters), the internal auditor and the external auditor, should attend its meetings. The committee should be entitled to meet with any relevant person outside the presence of executive or managing directors, if it so wishes.
  4. The internal and external auditors should, in addition to maintaining an effective working relationship with management, be guaranteed free access to the (supervisory) board. To this effect, the audit committee shall act as the principal contact point for the internal and external auditors.
  5. The audit committee should be informed of the internal auditor's work programme, and receive internal audit reports or a periodic summary.
  6. The audit committee should be informed of the external auditor's work programme, and should obtain a report by the external auditor describing all relationships between the independent auditor and the company and its group. The committee should obtain timely information about any issues arising from the audit.
  7. The audit committee should be free to obtain advice and assistance from outside legal, accounting or other advisors as it deems necessary to carry out its duties, and should receive appropriate funding from the company to this effect.
  8. The audit committee should review the process whereby the company complies with existing provisions regarding the possibility for employees to report alleged significant irregularities in the company, by way of complaints or through anonymous submissions, normally to an independent director, and should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.
  9. The audit committee should report to the (supervisory) board on its activities at least once every six months, at the time the yearly and half-yearly statements are approved.
-

## ANNEX II

**Profile of independent non-executive or supervisory directors**

1. It is not possible to list comprehensively all threats to directors' independence; the relationships or circumstances which may appear relevant to its determination may vary to a certain extent across Member States and companies, and best practices in this respect may evolve over time. However, a number of situations are frequently recognised as relevant in helping the (supervisory) board to determine whether a non-executive or supervisory director may be regarded as independent, even though it is widely understood that assessment of the independence of any particular director should be based on substance rather than form. In this context, a number of criteria, to be used by the (supervisory) board, should be adopted at national level. Such criteria, which should be tailored to the national context, should be based on due consideration of at least the following situations:
  - (a) not to be an executive or managing director of the company or an associated company, and not having been in such a position for the previous five years;
  - (b) not to be an employee of the company or an associated company, and not having been in such a position for the previous three years, except when the non-executive or supervisory director does not belong to senior management and has been elected to the (supervisory) board in the context of a system of workers' representation recognised by law and providing for adequate protection against abusive dismissal and other forms of unfair treatment;
  - (c) not to receive, or have received, significant additional remuneration from the company or an associated company apart from a fee received as non-executive or supervisory director. Such additional remuneration covers in particular any participation in a share option or any other performance-related pay scheme; it does not cover the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company (provided that such compensation is not contingent in any way on continued service);
  - (d) not to be or to represent in any way the controlling shareholder(s) (control being determined by reference to the cases mentioned in Article 1(1) of Council Directive 83/349/EEC<sup>(1)</sup>);
  - (e) not to have, or have had within the last year, a significant business relationship with the company or an associated company, either directly or as a partner, shareholder, director or senior employee of a body having such a relationship. Business relationships include the situation of a significant supplier of goods or services (including financial, legal, advisory or consulting services), of a significant customer, and of organisations that receive significant contributions from the company or its group;
  - (f) not to be, or have been within the last three years, partner or employee of the present or former external auditor of the company or an associated company;
  - (g) not to be executive or managing director in another company in which an executive or managing director of the company is non-executive or supervisory director, and not to have other significant links with executive directors of the company through involvement in other companies or bodies;
  - (h) not to have served on the (supervisory) board as a non-executive or supervisory director for more than three terms (or, alternatively, more than 12 years where national law provides for normal terms of a very small length);
  - (i) not to be a close family member of an executive or managing director, or of persons in the situations referred to in points (a) to (h);
2. The independent director undertakes (a) to maintain in all circumstances his independence of analysis, decision and action, (b) not to seek or accept any unreasonable advantages that could be considered as compromising his independence, and (c) to clearly express his opposition in the event that he finds that a decision of the (supervisory) board may harm the company. When the (supervisory) board has made decisions about which an independent non-executive or supervisory director has serious reservations, he should draw all the appropriate consequences from this. If he were to resign, he should explain his reasons in a letter to the board or the audit committee, and, where appropriate, to any relevant body external to the company.

---

<sup>(1)</sup> OJ L 193, 18.7.1983, p. 1. Directive as last amended by Directive 2003/51/EC of the European Parliament and of the Council (OJ L 178, 17.7.2003, p. 16).