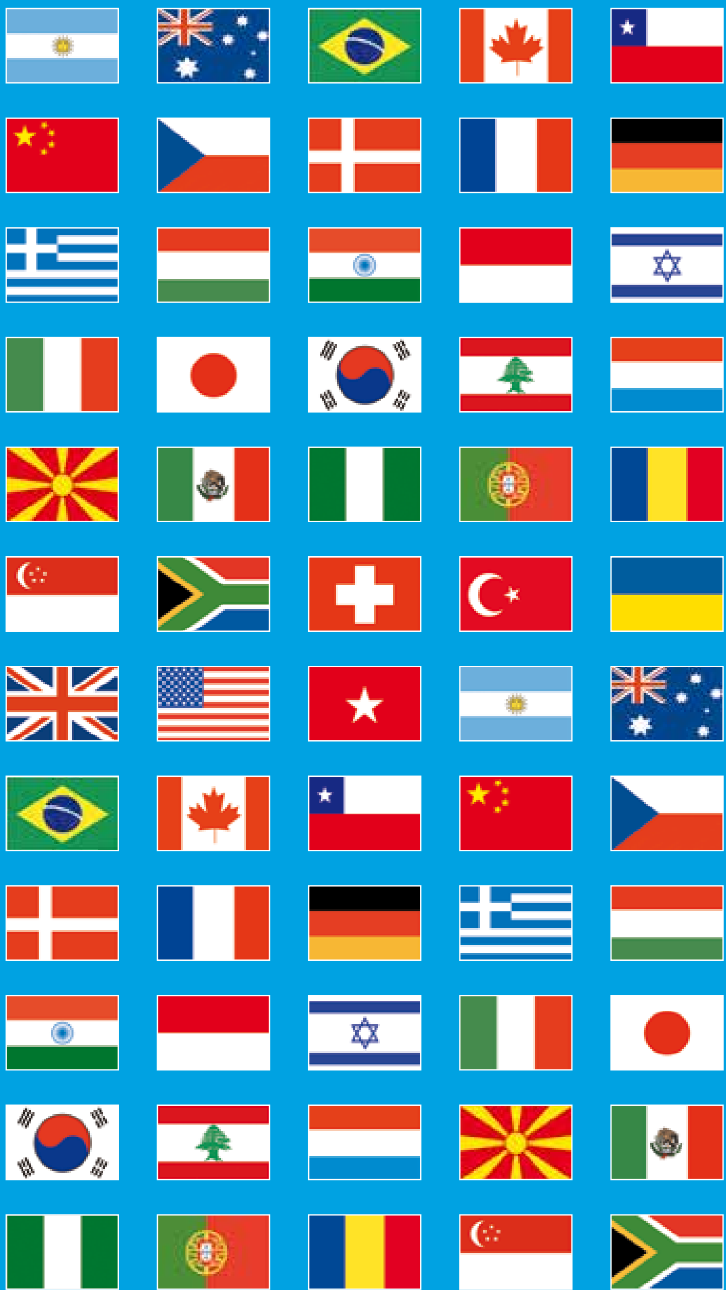
GETTING THE DEAL THROUGH

Corporate Governance

Board structures and directors' duties in 33 jurisdictions worldwide

2014



Published by
Getting the Deal Through
in association with:

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Anderson Mōri & Tomotsune
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Corporate Governance 2014

Contributing editor: Holly Gregory Sidley Austin LLP

Getting the Deal Through is delighted to publish the fully revised and updated thirteenth edition of *Corporate Governance*, a volume in our series of annual special reports providing comparative international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Corporate Governance 2014 addresses the most important issues facing corporations in relation to all their stakeholders. This publication examines various issues, including the rights of shareholders, corporate disclosure and transparency, responsibilities of the board and corporate control.

In the format adopted throughout the series, the same key questions are answered by leading practitioners in 33 jurisdictions worldwide. New jurisdictions this year include Argentina, China, Indonesia, Korea and South Africa.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually. Please ensure you are referring to the latest print edition or to the online version at www.GettingTheDealThrough.com.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We would like to thank Ira Millstein of Weil, Gotshal & Manges LLP for his stewardship of the title over the past twelve years and to acknowledge Rebecca Grapsas of Weil, Gotshal & Manges LLP for her kind assistance with this year's questionnaire. We would especially like to thank and acknowledge Holly Gregory of Sidley Austin LLP as contributing editor of this and future editions.

Getting the Deal Through
London
June 2014

Publisher
Gideon Roberton
gideon.roberton@lbresearch.com

Subscriptions
Rachel Nurse
subscriptions@gettingthedealthrough.com

Business development managers
George Ingledew
george.ingledew@lbresearch.com

Alan Lee
alan.lee@lbresearch.com

Dan White
dan.white@lbresearch.com

Law Business Research

THE QUEEN'S AWARDS FOR ENTERPRISE: 2012

Published by
Law Business Research Ltd
87 Lancaster Road
London W11 1QQ, UK
Tel: +44 20 7908 1188
Fax: +44 20 7229 6910

First published 2002
Thirteenth edition 2014
ISSN 1476-8127

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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Global Overview

Arthur Golden, Thomas Reid, Kyoko Takahashi Lin and Laura Turano

Davis Polk & Wardwell LLP

Corporate governance remains a hot topic worldwide this year, but for different reasons in different regions. In the United States, this year could be characterised as largely 'business as usual'; rather than planning and implementing new post-financial crisis corporate governance reforms, companies have operated under those new (and now, not so new) reforms. We have witnessed the growing and changing influence of large institutional investors, and different attempts by companies to respond to those investors as well as to pressure by activist shareholders. We have also continued to monitor the results of say-on-pay votes and believe that shareholder litigation related to executive compensation continues to warrant particular attention.

In contrast, in Europe and Asia, we believe that new reform measures (some of which have been recently adopted, and some of which are just beginning to be considered) are the most important corporate governance developments to flag. In the European Union, new measures include rules restricting banker bonuses, directives to increase transparency and shareholder access to information, auditor rotation requirements and resolutions to promote gender diversity in the boardroom. In Asia, we have largely focused on new corporate governance changes that we believe may be on the horizon, and key events that we think could prompt increased attention to corporate governance in the future. For example, we expect that discussions will continue in Hong Kong following the Alibaba IPO regarding whether dual-class shareholder structures should be accepted. Meanwhile, in Japan, Abenomics is promoting equity ownership and more active investment stewardship by Japanese institutional investors as a necessary corollary.

Overall, worldwide, we continue to see companies pressured by regulators, shareholders and proxy advisory firms with respect to their corporate governance practices. Although the heat may not be as intense as it was immediately after the financial crisis, it has far from subsided.

United States

Influence of proxy advisory firms and large institutional investors: ongoing shareholder outreach efforts

In 2013, we continued to observe the significant sway of proxy advisory firms on the outcome of director elections, say-on-pay and shareholder proposals. For example, it has been reported that, in 2013, shareholder support for say-on-pay votes at companies that had received a negative recommendation from Institutional Shareholder Services (ISS) was, on average, 30 per cent lower than at companies that had received a positive ISS recommendation. The shadow of the proxy advisory firms' influence was also demonstrated when (as discussed in more detail below) companies quickly retreated from certain by-law provisions regarding director compensation after ISS recommended against the members of the nominating and corporate governance committee of a company that had adopted the provision.

However, this level of influence has now inevitably resulted in political backlash, large institutional shareholders increasingly stressing that they make voting decisions based on their own independent analysis rather than solely relying on advice from the proxy advisory firms and companies becoming increasingly sophisticated at engaging directly with their large institutional investors.

Proxy advisory firms have been increasingly scrutinised in the last year for their influence over director elections and shareholder proposals. In June 2013, the Capital Markets and Government Sponsored Enterprises Subcommittee of the US House of Representatives held a hearing to discuss the role that proxy advisory firms play in corporate governance, during which nearly everyone on the committee agreed that the firms need to be more transparent in providing rationales for their policy decisions as well as explaining the methodologies behind their voting recommendations. This claim was echoed by Nasdaq in October 2013 when it filed a petition with the SEC asking the SEC to take action on proxy advisory firms and contending that there is little transparency to the methodologies and models that make up the firms' recommendations and how they apply them and that ISS's business model is inherently conflicted since ISS acts as a consultant and also advises companies on how to obtain higher ISS ratings. In December 2013, the SEC held a meeting to discuss the role of proxy advisory firms. We expect that the influence of the proxy advisory firms will continue to receive increased scrutiny and believe that over the medium and long term the SEC could consider significant rulemaking in this area. As discussed below, we have seen proposed rulemaking regarding proxy advisory firms in other regions. In the European Union, a recent directive was proposed that would require proxy advisory firms to implement adequate measures to guarantee that their voting recommendations are accurate and reliable and to publicly disclose certain information relating to their preparation of voting recommendations along with any actual or potential conflicts of interest.

Although the influence of proxy advisory firms is well recognised, in the past year we have also observed large institutional shareholders increasingly stress in the media and in letters to their portfolio companies that they reach their voting decisions independently of the proxy advisory firms and on the basis of their own in-house guidelines and analysis. For example, in anticipation of the 2014 proxy season, Vanguard sent letters to hundreds of its portfolio companies to proactively engage with them on corporate governance practices. The letters reportedly outlined Vanguard's views on corporate governance and provided Vanguard's contact information for further communications. Vanguard reported that a subset of these letters (to around 350 of its portfolio companies) contained specific requests for changes to governance practices or for further engagement. We believe that Vanguard's letter campaign was notable because it was a relatively public move for a large institutional investor that typically engages in quiet outreach and it was generally a call for universally adopting a set of governance principles (including annual director elections, majority voting and the right of 25 per cent of shareholders to call a special meeting) rather than the case-by-case analysis for which institutional investors are traditionally known. We believe the letter campaign may signal that some institutional investors are beginning to view these types of governance policies as accepted norms rather than best practices. We also expect that in the future large institutional investors are likely to engage in this type of outreach from time to time, and that companies will increasingly weigh the corporate governance policies of their large institutional investors in addition to the governance policies of proxy advisory firms.

Last year, we observed how activist tactics had evolved to include using corporate governance mechanics to drive strategic change at public companies, including by waging (or threatening to wage) campaigns to replace some or all of a target company's existing board members in order to then implement alternative business strategies (such as special dividends, share buy-backs, asset dispositions, acquisitions and spin-offs). This trend has continued, and shareholder activism investing is increasingly considered a separate, legitimate asset class. In the past year, activist shareholders have targeted large, well-respected companies, including Apple, DuPont, PepsiCo, Procter & Gamble and Mondelez. In order to pose a credible threat to such large companies, it is necessary for activists to seek out the support of other significant shareholders. This can have a disciplining effect on both the activist and company management; in order to appeal to such shareholders, the activist's message and the company's response generally must be precise, devoted to and well supported by financial metrics, and mainstream. (Personal criticism of either management or the activist are less likely to resonate.)

Recently, Canadian drugmaker Valeant Pharmaceuticals International announced that it had teamed up with Bill Ackman, a well-known shareholder activist, to make a US$45 billion bid for Allergan (the maker of Botox). We think the most interesting aspect of this news is that it demonstrates the different paths activist investors may take, the different alliances that may be formed and that no company is immune to activist campaigns.

While in some instances the willingness of certain institutional investors to align with activists has increased the array of potential targets, we have also seen some institutional investors warn against the tactics of activist shareholders. For example, in March 2014, the CEO of BlackRock wrote a letter to certain executives of S&P 500 companies warning these companies not to emphasise dividends or share buy-backs at the expense of future growth. BlackRock has stated that the letter was to counter 'short-term noise in the market' from activist investors, Wall Street analysts and the media. We believe that the BlackRock letter campaign is further evidence of the increasingly active role large institutional investors are taking with respect to corporate governance, a trend that we expect to continue. We would also note that, generally, it has become difficult for companies to characterise activist shareholders as short-term investors, given the holding periods of some activists and the time required to fully implement some activist proposals. As a result, companies often find arguments that focus on value creation rather than the activist's investment strategy are more likely to resonate with their shareholders.

Probably as a result of the continued influence of proxy advisory firms on shareholder votes and the increasing interest of large institutional investors on corporate governance matters, we have seen companies become more sophisticated at engaging with their institutional shareholders, as well as indirectly engaging with proxy advisory firms. More companies are choosing to engage with institutional shareholders and proxy advisory firms on a proactive basis during the proxy off-season, rather than limiting outreach to reactive, event-driven efforts. We would caution, however, that shareholder engagement in and of itself has not been shown to be a panacea. For example, after Abercrombie & Fitch received less than 25 per cent support for its say-on-pay vote in 2012, the company reportedly made extensive shareholder outreach efforts and several changes to its compensation arrangements (but not in the design of the CEO's option awards, which had been criticised by ISS). Despite its extensive outreach efforts and changes, Abercrombie & Fitch suffered another failed say-on-pay vote in 2013, receiving even less shareholder support (20 per cent).

By-law amendments: exclusive forum and director compensation

In recent years, we have watched as exclusive forum provisions mandating that shareholder litigation be channelled to an exclusive jurisdiction (in most cases, Delaware) gathered steam, with over 250 public companies (including Chevron and FedEx) adopting such provisions. The push behind these provisions was renewed in June 2013 when the Delaware Court of Chancery (unsurprisingly) held that a Delaware exclusive forum provision in corporate by-laws is at least facially valid. The push was further strengthened in October 2013, when the appeal to the Chancery Court's decision was dropped. (We note that the author of the Delaware Court of Chancery decision has since become Chief Justice of the Delaware Supreme Court.)

It remains to be seen how shareholders will react to exclusive jurisdiction by-law provisions and whether (and which) non-Delaware courts will enforce such provisions. ISS's reaction has been mildly negative to these provisions, and Glass Lewis has been firmly negative, but so far shareholder support for these provisions has been inconsistent. We believe it will be important to watch how (and at what pace) a body of law will develop in other states with respect to these provisions, as well as how shareholder consensus ultimately develops.

In addition to exclusive forum provisions, another area of by-law activity in the past year has involved provisions related to director compensation. In the past year, at least 30 companies adopted by-law provisions that prohibited from serving as directors persons who are party to any compensatory arrangement related to their director service with anyone other than the company. After ISS recommended against the directors who served on the nominating and corporate governance committee of Provident Financial (one of the first of such companies to hold its annual meeting) for unilaterally adopting such provisions, almost all of the companies amended their by-laws to eliminate the provision. ISS criticised the provisions as 'significantly [impacting] shareholders' rights' by 'unduly restrict[ing] investors' ability to nominate and elect otherwise qualified individuals via a proxy contest' and warned that if a board adopts director compensation disqualification provisions without submitting them to a shareholder vote ISS 'may' recommend a withhold vote for 'material failures of governance, stewardship, risk oversight, or fiduciary responsibilities'.

We expect that companies will continue to shy away from adopting director compensation by-laws in light of ISS's threat that it may withhold vote recommendations for boards that adopt these provisions and will instead rely on by-law provisions which require disclosure of any third-party compensation arrangements (and use the existence of such arrangements against a nominee in the proxy contest). Ultimately, we believe that the distinction, from a corporate governance perspective, between a board unilaterally adopting by-law provisions that prohibit from serving as directors persons who receive reasonable compensation in exchange for agreeing to stand for election (which compensation is often necessary to recruit high-quality independents to run in a proxy contest) and who receive any compensation with respect to board service following election (which may create questions regarding alignment of economic incentives depending on the circumstances), will become more accepted. We also believe it will be interesting to watch what happens to companies that have refused to eliminate these provisions or have put these provisions out for shareholder vote this proxy season.

Litigation and negotiation of shareholder proposals

During the 2014 proxy season, we have seen four large, well-known public companies – Express Scripts, EMC Corp, Omnicom and Chipotle – file suit against John Chevedden (a notoriously prolific shareholder proponent) rather than seek no-action relief from the SEC (or, in one case, filing suit after no-action relief was denied by the SEC). At the time of writing, three of these four suits had ended in losses for the companies, and a 'who's who' list of institutional shareholders began a campaign focusing attention on these lawsuits and arguing that the companies, by bypassing 'well-established, functional and mutually-agreed upon processes… [diminish] the authority of the SEC'. Although up until now, a number of companies have succeeded in obtaining declaratory judgment permitting them to exclude Chevedden's proposals from their proxy materials, the failure of companies this year to receive relief from the courts underlines that for this type of litigation the outcome is uncertain, and there may be reputational costs in addition to court fees.

In contrast to the *Chevedden* litigation, we have also seen companies increasingly choose to negotiate with professional activists and others. A few examples include:

- eBay obtaining the withdrawal of Carl Icahn's proposal for eBay to divest PayPal in exchange for eBay agreeing to appoint a single independent director recommended by Mr Icahn;
- Apple obtaining the withdrawal of a shareholder proposal regarding board diversity in exchange for stronger language in its nominating committee charter with respect to board diversity;
- Disney obtaining the withdrawal of a shareholder proposal regarding chairman independence in exchange for amending its corporate governance guidelines to include a (carefully hedged) statement that in the future the chairman would 'in the normal course' be independent unless the board determined otherwise; and
- Exxon obtaining the withdrawal of a shareholder proposal regarding climate change in exchange for public disclosure of its carbon emissions.

We believe that the trend to negotiate with shareholder activists on some matters represents not only a desire by companies to avoid unnecessary reputational damage and to save time and money, but also the increased tendency of activists to be more focused and limited in their demands and the increased ability of companies to predict the outcome of a shareholder vote, assess their leverage and negotiate accordingly.

Say-on-pay

In the United States, 2014 represents the fourth year of say-on-pay votes for most public companies. Say-on-pay votes have largely become 'business as usual,' and strong voting results in S&P 500 companies in 2013 and so far in 2014 can be attributed to companies being sensitive and adept at emerging governance practices and say-on-pay nuances, devoting resources to shareholder engagement and updating their pay practices.

Most companies (93 per cent) in the Russell 3000 have passed their say-on-pay votes each year since voting became mandatory in 2011. For companies that have received low support in any single year, a positive lesson of say-on-pay votes continues to be that it is possible for companies to improve their vote results from prior years. In 2013, companies that failed say-on-pay votes in 2012 received significantly more support (+38 per cent on average). In addition, companies that received low support (50 to 70 per cent) in 2012 received 15 per cent more support, on average, in 2013. Even companies that received 70 to 90 per cent support in 2012 received 4 per cent more support, on average, in 2013.

For companies that have received strong support in previous years, however, we continue to caution that it is important not to become complacent. In 2013, some companies that had received strong support in previous years failed to receive majority support or saw a meaningful reduction in support. Companies whose performance, relative to peers, is volatile, or whose pay, relative to peers, is high, should be particularly mindful that when a company's performance trend is reversed, its compensation programmes may be subject to a more thorough and more critical review by proxy advisory firms and institutional shareholders. We recommend that companies maintain open lines of communication with shareholders so that if trends are reversed and the company receives a negative ISS recommendation, it can respond quickly and effectively. Similarly, conversations with the proxy advisory firms during the proxy off-season to explain compensation programme design and philosophy are likely to be more effective than simply attempting to reach out to proxy advisory firms after their recommendations have been issued or making supplementary filings in response to proxy advisory firm vote recommendations.

Executive compensation-related litigation

In our 2013 Global Overview, we flagged the emergence of litigation relating to companies' annual proxy disclosure. In the past, litigation alleging inadequate proxy disclosure was primarily focused on disclosures in merger proxies, where shareholder approval was solicited in the context of a public company acquisition. It has become increasingly common, however, for lawsuits to also focus on disclosures in annual meeting proxies, such as proposals to increase the number of shares available for issuance under equity plans or to approve new equity plans. Although so far in 2014 there has been less litigation of this nature than in 2013, we expect that companies will continue to prepare compensation sections of the proxy statement with the threat of such lawsuits in mind.

Pay ratio disclosure

In 2013, the SEC issued its proposal to implement the 'CEO pay-ratio' disclosure requirements under section 953(b) of the Dodd-Frank Act. This proposal has received considerable attention in the media and in the boardroom, as compensation committees begin to consider how their companies will comply with the proposal. The proposed rule would require certain SEC reporting companies to publicly disclose:

- median annual total compensation of all employees in the company (including all full-time, part-time, temporary, seasonal and non-US employees);
- annual total compensation of the CEO; and
- the ratio of the median annual total compensation of all employees to the annual total compensation of the CEO.

Assuming the SEC adopts final rules in 2014, a company with a calendar fiscal year would be required to disclose pay-ratio information relating to 2015 compensation in its 2016 proxy.

The flexibility provided in the proposed rule addresses some of the concerns that had been previously raised regarding compliance costs and burdens of disclosure. It will be interesting to watch, however, what relief, if any, the SEC provides with respect to the inclusion of part-time, seasonal and non-US employees in the calculation.

Focus on board tenure

In prior years we have discussed efforts to increase diversity in the boardroom. We expect that board tenure will be the next board-composition focal point for corporate governance advocates. We believe this will be an important issue to monitor, because the average tenure for directors at S&P 1500 companies is approximately 10.8 years, very few US public companies currently have term limits for directors, and views are largely split on whether shareholders are best served by new directors (who may be more independent stewards of the company) or longer-serving directors (who are often best positioned to effect change and challenge management).

We think it is possible that just as say-on-pay was imported from the UK, the next UK import may be rules regarding board tenure. (In the UK, although a board member is not required to resign after a certain number of years, a board is required to explain in its annual report why a director who has served for more than nine years may be considered independent.) We believe that in the United States, best practice for (or even rules regarding) board tenure may develop to evaluate the overall tenure and turnover of the board, rather than the tenure of any particular director.

Separation of chairman and CEO roles

The number of companies each year that receive shareholder proposals to separate the chairman and CEO roles continues to increase. Although a majority of S&P 500 companies have combined chairman and CEO roles, it has been reported that this percentage has decreased by approximately 15 per cent over the past 10 years. While in the past two years approximately 200 companies received shareholder proposals to separate the roles of chairman and CEO, only a handful of the proposals garnered majority support. We believe that although shareholder proposals on this issue are likely to continue to increase, change – especially so long as economic data indicates that separating the chairman and CEO roles does not result in better performance – will move at a glacial pace and more as a result of natural evolution than in response to shareholder pressure.

Europe

Continued focus on remuneration: limits on banker bonuses and executive pay in the crosshairs

Rules regarding remuneration at financial institutions continue to dominate the corporate governance agenda in Europe. Generally speaking, the move towards stricter regulation of remuneration has resulted in a confusing web of overlapping EU directives and local EU member state law and regulation. For the purposes of our overview, we will limit ourselves to a few highlights.

In March 2014, the European Commission adopted delegated legislation to finalise certain details of the CRD IV rules on remuneration, which cap bonuses of certain bankers to 100 per cent of an employee's fixed salary, or 200 per cent with shareholder approval. CRD IV took effect from 1 January 2014 and will apply to remuneration for services provided or for performance during 2014 and for each subsequent year. The CRD IV remuneration rules apply to directors and senior managers at credit institutions and investment firms, as well as employees who are considered to have a material impact on the institution's risk profile, including, among others, employees who:

- earned €500,000 or more in the preceding financial year;
- are the heads of certain divisions including human resources; or
- trade certain amounts of capital.

In April 2014, members of the European Parliament's economic affairs committee dropped their threat to hold up implementation of the delegated legislation. In addition to the bonus cap, other rules and guidelines with respect to fixed pay, variable pay, percentage of equity remuneration, deferred remuneration and clawbacks for employees at financial institutions have been adopted in the past year.

We believe it will be important to watch how affected financial institutions and employees respond to the new rules, and how (and to what extent) regulators clamp down on efforts to circumvent or adapt to the new rules. The UK government has also sued to block the new rules, claiming, among other things, that the rules have inadequate treaty legal base, are disproportionate and fail to comply with the principle of subsidiarity. The outcome of this lawsuit as well as the continued rhetoric in the UK surrounding remuneration will be important to watch.

In addition, we believe it will be important to monitor the European Commission's efforts to allow shareholders a veto over pay packages for executives at publicly traded companies. In April 2014, the European Union financial services chief, Michel Barnier, called for shareholders throughout the European Union to have a binding vote on remuneration policies at least once every three years. Currently, 13 EU countries provide for a shareholder vote on pay (with two countries, Italy and Spain, providing for a non-binding vote). In addition, the UK recently adopted new rules requiring publicly traded companies to provide additional disclosure regarding director remuneration, and to subject the company's director remuneration to a binding shareholder vote at least every three years.

In April 2014, Vince Cable, the UK's business secretary, warned the 100 biggest UK-listed companies of the reputational harm of awarding large pay packages. Expressing concerns that some companies are ignoring the spirit of the reforms, Mr Cable has cautioned that stricter regulatory oversight of pay reports and policies could be on the horizon.

We will watch with interest how boards will balance (and how they will be perceived as having balanced) the sometimes conflicting objectives of retaining and attracting talented directors and employees, and of maintaining and promoting a positive public image and a strong working relationship with regulators.

Shareholder Rights Directive

The Shareholder Rights Directive was adopted in July 2007 with the aim of improving corporate governance at EU publicly traded companies by enabling shareholders to exercise their voting rights and information access rights across borders. In April 2014, the European Commission proposed amendments to the Shareholder Rights Directive. These amendments cover a number of topics, including, among other things:

- the transmission of information to shareholders (to prevent undue delay of the transfer of information among intermediaries);
- certain disclosures relating to the investment strategies of institutional investors and asset managers;
- required disclosure by proxy advisory firms (including disclosure of information relating to their preparation of voting recommendations and actual or potential conflicts of interest);
- the right to vote on certain remuneration matters related to directors; and
- the right to vote on related-party transactions (when the transaction involves more than 5 per cent of the company's assets or could have a significant impact on profits or turnover).

Auditor rotation to become mandatory; cap on non-audit fees

In April 2014, the European Parliament adopted its first reading position relating to the proposals for new legislation on statutory audit of public-interest entities (PIEs), including EU-listed companies, banks and insurance companies. This follows the preliminary agreement reached between the European Parliament and EU member states in December 2013. Among other things, it is proposed to require audit firms at PIEs to rotate every 10 years (with a potential extension for up to 14 additional years if there is a joint audit). In addition, a cap of 70 per cent of the audit fee on fees generated for non-audit services based on a three-year average is also proposed, along with a 'blacklist' of non-audit services (including services linked to the financial and investment strategy of the PIE) that may not be provided by a PIE's auditor. The EU commissioner has stressed that these changes are designed to increase audit quality and restore investor confidence in financial information.

Gender diversity in the boardroom

As we have previously reported, in 2011 the European Commission called for publicly listed EU companies to sign a voluntary pledge to increase the presence of women on corporate boards to 30 per cent by 2015 and 40 per cent by 2020 through actively recruiting qualified women to replace outgoing male board members. Following a consultation process, in November 2012, the Commission published the provisional text of a directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges. This past year, the European Parliament passed a legislative resolution adopting the Commission's proposal, as amended. The amended proposal requires that listed companies, where the underrepresented sex represents less than 40 per cent of non-executive board positions, make appointments on the basis of a comparative analysis of the qualifications of each candidate in order to obtain 40 per cent representation by 1 January 2020 (or by 1 January 2018 for public undertakings). We expect that diversity in the boardroom will continue to be a hot topic around the world. As noted above, in the United States, blue-chip companies such as Apple have received shareholder proposals on this issue in the past year. In the UK, there continues to be progress; a recent report indicated that the percentage of women board members of the FTSE 100 and FTSE 250 is 20.7 per cent and 15.6 per cent respectively (compared with 12.5 per cent and 7.8 per cent three years ago).

Asia

Hong Kong: public consultation on dual-class structure

In Hong Kong, a hot topic has been whether public companies should be permitted to have dual-class shareholder structures. Alibaba, one of several large e-commerce businesses in China, reportedly wished to launch an IPO on the Hong Kong stock exchange using a dual-class structure that would enable the company's founders and management to maintain control. In Hong Kong a dual-class structure requires the approval of Hong Kong's Securities and Futures Commission. Although in the past the Securities and Futures Commission turned down a similar request by UK football club Manchester United (later listed on the NYSE), some were hopeful that the Alibaba IPO would sway regulators. In the end, reportedly after more than a year of talks with Hong Kong regulators and stock exchange officials, Alibaba abandoned its plans to list on the Hong Kong exchange and decided to list on the NYSE. We believe it will be important to monitor whether the Alibaba IPO spurs regulatory change in this area (either in Hong Kong or in the United States). Although in April 2014, the Asian Corporate Governance Association released the results of a survey of its members (which includes institutional investors with over US$14 trillion, in aggregate, under management) indicating that nearly all respondents were opposed to dual-class structures, we believe that the debate in Hong Kong over preserving the 'one share, one vote' principle is far from over.

Japan: potential governance changes on the horizon

Corporate scandals involving Olympus Corporation and Daio Paper Corporation in 2011 turned the spotlight on corporate governance standards in Japan. As readers may recall, the Olympus Corporation scandal involved the concealment of significant potential losses, and the Daio Paper scandal involved the transfer of significant amounts of money to a representative director that were used to support his gambling habits. In response to these scandals, in 2012, the Liberal Democratic Party's election manifesto promised governance reforms. This past year we have seen the spotlight on corporate governance intensify when it was discovered that Mizuho Bank, Japan's third-largest bank by market capitalisation, had loaned money to alleged organised crime syndicates.

Recent corporate governance developments in Japan include the finalisation of the stewardship code for institutional investors in February 2014 and the announcement by Shinzo Abe, the current Prime Minister of Japan, of additional sweeping corporate governance changes. The last piece of Mr Abe's governance plan, a broad code to guide company behaviour, is expected in summer 2014. We have also observed some substantive corporate governance reform at major Japanese companies. A majority of directors on Hitachi's board are now outsiders, and Sumitomo Chemical and Toyota have each recently appointed their first outside directors.

Japan: public shareholder demands; expectation of more activism in the future

In early 2014, the Life Insurance Association of Japan released a report demanding that Japanese companies start setting shareholder return targets and also work to increase profit margins. Although Japanese institutional investors own around 30 per cent of the stock of all publicly traded Japanese companies (with Japanese life insurance companies alone owning around 4 per cent of the stock of all publicly traded Japanese companies), publicly these investors have been largely quiet on corporate governance and financial performance matters at Japanese companies, reflecting the relative proportions of equities versus fixed income securities in their portfolios. By no means do we believe that this will change overnight and any shift in portfolio weightings may be constrained by the relatively older age of the typical Japanese pension plan participant or policyholder relative to the typical demographic in the United States. However, we do believe that this is an interesting corporate governance development to note.

Last year, many were surprised when Daniel Loeb, a well-known US activist shareholder, took aim at Sony. Although a number of high-profile foreign activists targeted underperforming Japanese companies in the mid-2000s, nearly all of those attempts ended in the activist's retreat. We expect that shareholder activism in Japan will continue to increase as a result of increased foreign ownership (it has been reported that over 30 per cent of the stock of Japanese public companies is currently held by non-Japanese persons) and the growing legitimacy of shareholder activism investing as an asset class. We also believe that it will be interesting to watch how the activist playbook evolves in Japan to attract the support of institutional shareholders and to try and work effectively with company management.

Davis Polk

Arthur Golden arthur.golden@davispolk.com
Thomas Reid tom.reid@davispolk.com
Kyoko Takahashi Lin kyoko.lin@davispolk.com
Laura Turano laura.turano@davispolk.com

450 Lexington Avenue
New York
NY 10017
United States

Tel: +1 212 450 4000
Fax: +1 212 701 5800
www.davispolk.com