

Corporate Governance Code Monitoring Committee

second report on compliance with the
Dutch corporate governance code

December 2006

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

www.commissiecorporategovernance.nl

Contents

Summary

Introduction

Chapter 1 – Findings

1. Compliance with the corporate governance code by listed companies
2. Activities of shareholders
3. International developments
4. Internal risk management and control systems

Chapter 2 – Assessment and analysis

1. Internal risk management and control systems
2. Remuneration policy

Chapter 3 – Conclusions

Composition of Corporate Governance Code Monitoring Committee

Summary

Well-managed companies are of crucial importance to the health and competitiveness of the economy. The Dutch corporate governance code (referred to below as the code), which was drawn up by the Corporate Governance Committee (otherwise known as the Tabaksblat Committee), contains principles and best practice provisions amplifying the conditions for good corporate governance: good entrepreneurship (including integrity and transparency of decision-making by the management board) and proper supervision thereof (including accountability for such supervision).

Compliance with the code is mandatory (by law) for listed companies. Compliance is in accordance with the 'apply or explain' principle. In other words, provisions of the code should be applied unconditionally or an explanation should be given for any departure from them. The management board and supervisory board of a company account to the shareholders for the corporate governance structure that has been adopted, and for compliance with the code.

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

The following aspects are central to this year's report:

- (a) determination of the extent to which the code is applied by listed companies;
- (b) activities of shareholders, including compliance by trust offices and institutional investors;
- (c) international developments;
- (d) internal risk management and control systems;
- (e) remuneration policy.

This year's report focuses in part on the quality of the explanation given by companies for non-application of the code.

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

Compliance with the code by companies

The rate of compliance with the code is higher than last year. On average, the companies comply with 96% of the code provisions.¹ Despite the high rate of compliance with the code the Committee stresses that compliance should be 100%. This is not to say that all provisions of the code should be applied unconditionally. Departures from the code are possible provided that they are explained.

Local companies lag behind the AEX, AMX and AMS companies in terms of compliance with the code. The Committee considers that the size of these companies should not be an excuse for less strict observance of the code. The provision of an explanation in the event of a departure from the code (irrespective of the size of the company) is always possible.

A survey was conducted to ascertain how explanations may be classified. As the survey inevitably involves an element of subjectivity, the Committee believes that the results should be viewed with caution. 85% of the explanations given for departures from the code can be classified as *understandable*. Whether the explanation given is verifiable (by reference to information in the public domain) is assessed as positive or neutral in 47% of the cases. The assessment is negative in 12% of the cases. In the remaining cases, it is not possible to give a clear view on whether the explanation is verifiable. The Committee calls on companies to give explicit consideration in the next financial year to ensuring that any explanation given is understandable and verifiable. An explanation qualifies as sound if it is understandable and verifiable. None of this detracts from the general principle that it is for the shareholders to express an opinion on a departure from the code.

The Committee observes that its job is to give an overall picture of compliance with the code by listed companies. The figures on which this is based are generic. The Committee does not make any pronouncements about the manner in which individual companies comply with the code. The Financial Markets Authority (AFM) will supervise annual reporting by companies from 1 January 2007. It is exclusively up to the shareholders to accept the explanation for departures from the code.

The code and shareholders (and general meetings)

The average attendance rate at general meetings is 56% (44% if companies that have issued depositary receipts for shares are disregarded). Like last year, this is on the low side. As a result, shareholders who do attend can influence the course of the meeting disproportionately.

The Committee has considered the place generally accorded to the treatment of corporate governance on the agenda of the general meeting. The Committee considers that it follows from the code that, in so far as corporate governance items are on the agenda, they should be placed before the item dealing with the discharge of the management board from liability for its policy.

¹ It should be noted that the foreign companies have not been included in the calculation this year.

The changes that have occurred in relation to the issue of depositary receipts for shares and anti-takeover measures are viewed positively. The Committee welcomes the fact that most trust offices grant voting proxies to depositary receipt holders without any limitations.

On average, 30% of institutional investors comply with the code (a low figure, like last year). The Committee regrets this, all the more so because the effectiveness of the code relies – to a significant extent - on a proactive attitude on the part of shareholders.

Practicability of the code

The rate of application of the code provisions is 92%. It can be inferred from this that the code is eminently practicable. The Committee's survey shows that the application of the code is below average in two areas, despite clear improvements since last year. This concerns provisions of the code relating to:

- remuneration policy; and
- the statement on internal risk management and control systems.

The Committee has studied these two issues in more detail.

Remuneration policy

The Committee is concerned about the lack of transparency about directors' pay and (the implementation of) the remuneration policy. The remuneration policy and its impact must be presented to the general meeting of shareholders in transparent and understandable terms. This responsibility falls to the supervisory board; in practice, this requires the supervisory board to monitor the complexity of remuneration contracts. The Committee recommends that the remuneration policy be covered in a separate section of the annual accounts, in a manner that is both transparent and uniform.

The Committee also believes that the supervisory board should explicitly report on the effectiveness of the company's remuneration policy. In particular, the relationship between remuneration and performance should be made clear, not only before but also after the event. Performance should be interpreted in this connection as the contribution to long-term value creation by the enterprise.

Internal risk management and control systems

The application of best practice provision II.1.4 (concerning the management board statement about the functioning of the internal risk management and control system) has been greatly improved since last year. Within this context, the Committee takes into that in the past year not all companies have yet been able to organise their systems on the basis of the good practice recommendations in the Committee's first report of December 2005. The extent to which companies have incorporated the 2005 recommendations of the Committee will only become fully apparent in the report on the 2007 financial year. Accordingly, the Committee does not regard it as desirable to produce further guidelines this year. The Committee confirms, for the record, that it expects companies to take its 2005 recommendations to heart in their reports on 2006.

The Committee believes that the present system, as contained in the code and in the first Monitoring Report, should be and remain principle-based. A generally accepted practice can be established in the market by the various parties concerned, in consultation among themselves. The Committee does not consider it expedient at present to introduce further national rules. Nor does it consider that a more stringent interpretation of the principles in detailed implementation rules would be desirable.

The Committee would observe that, in the present set-up, the role of the external auditor is to identify deficiencies and not to check or verify the internal risk management and control systems: if the report of the external auditor to the supervisory board mentions serious deficiencies, the auditor should check that they are also described in the annual report. If this is not the case, the auditor has a duty to draw attention to these deficiencies in his report. The management board and supervisory board are responsible for the annual report; the external auditor has an indirect responsibility for it by virtue of his report and his duty to identify deficiencies. The Committee is therefore not in favour of disclosure of the external auditor's report to the supervisory board and the management board.

Consultation document

In the first report, the Committee announced that in 2006 it would focus, among other things, on the preparation and effectiveness of the general meeting of shareholders, on the dialogue between the company and shareholders, and on compliance with the code by local companies and 'Dutch' companies primarily listed abroad.

The second report provides information about compliance with the provisions of the code in these fields. In addition to the progress report on compliance with the provisions of the code, the Committee considers it useful to submit a consultation document dealing with the role of shareholders and the scope of the code.

Future activities

The Committee will proceed with its work in 2007. The monitoring of compliance with the code and the best practice provisions will be continued in the year ahead. Depending on the degree of application of the code in practice, the Committee will make more far-reaching recommendations next year.

In 2007 the Committee will devote extra attention to the role of shareholders and to the scope of the code. The Committee will present its recommendations and the results of the above-mentioned consultations to the government in the first half of 2007.

More information about the theme of remuneration and remuneration policy will be gathered in 2007. In addition to its regular monitoring of related parts of the code, the Committee will report, in 2007, on the results of its further survey of the relationship between the performance of management board members and their remuneration (particularly the variable components). An empirical survey of this kind has now been instituted by the Committee among Dutch listed companies.

Introduction

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

The Minister of Finance, acting also on behalf of the Minister of Justice and the State Secretary for Economic Affairs, set up the Corporate Governance Code Monitoring Committee (the Committee) on 6 December 2004. The Committee's official terms of reference are to help ensure that the code is practicable and up to date, and to monitor compliance by Dutch listed companies and institutional investors. It has been agreed that the Committee should publish a report annually for this purpose. In front of you is the second report of the Committee.

The report you now have before you covers the 2005 financial year, which was the second financial year in which Dutch listed companies were obliged to comply with the code. These companies reported to their shareholders on the 2005 financial year in 2006. During the general meetings, the shareholders were able to express their views on the actual application of the code and on the interpretation given in cases where companies departed from the provisions of the code.

The structure of the report is the same as that of last year's report. Chapter 1 contains the findings on compliance with the code. The surveys carried out on behalf of the Committee by the University of Groningen (compliance with the code by listed companies) and Rematch BV (activities of shareholders), together with the market consultations held by the Committee, provide the basis for large parts of this chapter². Chapter 2 provides a more detailed examination, and analyses the background to the operation of certain provisions of the code in practice. This year, our attention focuses on internal risk management and remuneration. Lastly, chapter 3 sets out conclusions.

A change has occurred in the composition of the Committee in the past year. Professor H.P.J. Ophof has retired from the Committee and has been succeeded by Professor R.H. Maatman. The Committee thanks Professor Ophof for his work on its behalf.

² The surveys conducted by the University of Groningen and Rematch BV are available via the Committee's website (www.commissiecorporategovernance.nl). Please note that the reports are based on the survey commissioned by the Committee. However, the Committee is not responsible for the content of the above surveys.

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

Finally, the Committee wishes to reflect on a very sad event. On 14 October last Marco Knubben, one of our secretaries, died at the age of 32. Marco worked for us with great dedication, right up to the time when he became confined to bed. Our thoughts go out to his wife, children, parents, brother and grandmother, and to his other relatives and friends. The Committee will miss Marco's presence.

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

Chapter 1 - Findings

1. Compliance with the corporate governance code by listed companies

1.1 Introduction

This part of the report examines compliance with the code by Dutch listed companies in 2005. These companies have been obliged since the 2004 financial year to comply with the provisions of the code relating to the management board and supervisory board. Compliance means unconditionally applying a provision of the code or explaining in the annual report of the company why the provision is not applied³.

To allow the figures in this report to be compared with those of last year's report, the Committee has decided to use the same text layout as in the report on the 2004 financial year. Section 1.2 explains the approach adopted by the Committee to the monitoring of compliance with the code. Section 1.3 gives a general overview of compliance with the code in 2005. Section 1.4 deals with the non-application of provisions of the code; this section includes a quantitative analysis. Section 1.5 gives a qualitative analysis of the non-application of provisions of the code. Section 1.6 examines non-compliance with the provisions of the code. Some provisions of the code that have a below-average chance of being applied and/or complied with are considered in section 1.7. The code provisions dealing with the internal risk management and control systems are considered in section 1.8. Section 1.9 examines provisions of the code dealing with the remuneration of management board members. Section 1.10 considers non-compliance with the provisions of the code by *foreign* companies. Lastly, section 1.11 contains several points of attention.

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

1.2 Approach

To obtain objective information about compliance with the code, the Committee once again (like last year) commissioned a survey by the University of Groningen (RuG). This survey covers the manner and extent to which listed companies comply with the code. The survey covers all Dutch 25 AEX, AMX, AMS and local companies, insofar as the requisite information was in the public domain at the time when the survey was completed (September 2006). The survey by the University of Groningen does not therefore use a predetermined sample group of companies.

Like last year, the Groningen survey examines compliance with the code at the level of individual provisions (or parts of provisions). This approach has been chosen because it provides the most objective possible picture of problems affecting compliance with the code. However, the research method leaves no scope for nuances. Instead, it records whether something is applied or explained. No account is taken of the quality of the explanation. The Committee is aware of this limitation and has therefore requested the University of Groningen this year to prepare both a quantitative and a qualitative analysis of the explanations for derogating from the code.

As the code has the force of law, all companies listed on a stock exchange abroad but having their registered office in the Netherlands are obliged to comply with the code. The survey on compliance with the code covering the 2004 financial year revealed that this category of companies had performed less well in this respect than other categories of companies. The University of Groningen was therefore asked to devote separate attention to this category (which we will refer to below as 'foreign companies'). The survey of this category of company is based on a random sample.

The survey covers a total of 24 AEX companies, 22 AMX companies, 23 AMS companies⁴, 50 local companies and 27 other (foreign) companies⁵.

In addition to the survey by the University of Groningen, the Committee has drawn on the findings of the survey of the activities of shareholders in 2006 in the context of general meetings. This survey was carried out on behalf of the Committee by Rematch. Finally, the Committee has once again made grateful use of published reports on compliance with the code. These reports, which were not commissioned by the Committee, contain findings by various interest groups and experts, and have helped to broaden the Committee's understanding.

⁴ AEX: Amsterdam Exchanges – shares index
AMX: Amsterdam Midkap - shares index
AMS: Amsterdam Smallcap – shares index

⁵ Unlike last year's survey, the present survey does not use a subgroup consisting of the 14 AEX companies with the largest market capitalization. The monitoring results of this category in last year's survey were largely the same as the results for the entire AEX.

1.3 General picture

Compliance with the code has risen in relation to last year. On average, companies listed on a Dutch stock exchange complied with 96% of the code provisions. As stated in the introduction, companies are deemed to comply with the code even if they explain why a best practice provision is not applied. As the code has the force of law, the companies are obliged to comply with it. It should be noted that the Committee does not comment on the manner in which individual companies comply with the code. As of 1 January 2007, the Dutch Financial Markets Authority (AFM) will supervise annual reporting by companies. It is exclusively up to the shareholders to accept the explanation for departures from the code.

Proper compliance with the code involves giving a thorough interpretation of why best practice provisions are not applied. This is why the Committee has this year commissioned a survey not only of the average compliance and application percentages, but also of the explanation given for derogating from the code. The findings of this survey are examined in section 1.5. The chief findings of this survey are:

- 85% of the explanations given can be described as 'understandable'. The term 'understandable' is used where an explanation provides information as to why a company has not complied with the best practice provision in question.
- Whether the explanation given is verifiable (by reference to information in the public domain) is assessed as positive or neutral in 47% of the cases. The assessment is negative in 12% of the cases. In the remaining cases, it is not possible to give a clear view on whether the explanation is verifiable.

Categories of companies in the survey

Various changes have taken place since last year in the rates of application and compliance by each category of company in the survey.

- AEX companies applied more code provisions in the 2005 financial year than in 2004. However, the total compliance percentage in 2005 (97%) was the same as in 2004. It follows that there were fewer explanations.
- The compliance percentages of the AMX and AMS companies (97.5%) were the highest of all the categories examined.
- Local companies had the lowest rate of compliance (92%) and application (86%). The rates of application and compliance were nonetheless substantially higher than in the 2004 financial year.

The breakdown of rates of code compliance and application for each category of company is as follows:

	Financial year 2005			Financial year 2004		
	<i>Compliance</i>	<i>Application</i>	<i>Explanation</i>	<i>Compliance</i>	<i>Application</i>	<i>Explanation</i>
All Dutch companies	96%	92%	4%	92	87%	5%
AEX	97%	94%	3%	97%	91%	5.5%
AMX	97.5%	94%	3.5%	94.5%	91%	3.5%
AMS	97.5%	93%	4.5%	95%	88%	7%
Local companies	92%	86%	6%	83%	77%	6%

Foreign companies

The code applies to all companies whose registered office is in the Netherlands and whose shares or depositary receipts for shares are officially listed on a government-recognised stock exchange. It follows that the code also applies to companies that are listed only on foreign stock exchanges (hereafter: foreign companies).

Last year's survey showed that the compliance and reporting pattern of the *foreign* companies category clearly differed from that of other categories of company. It was also apparent that the management structure of these companies was often based on non-Dutch legislation (ie, legislation applicable in the country of listing). The management structure was found to be a factor that influenced the scope for applying or complying with the Dutch corporate governance code. Owing to this divergent pattern, the Committee decided this year to commission a separate survey of compliance by *foreign* companies. The findings of this survey are examined in section 1.9.

Compliance with parts of the code

The following table gives an overview of compliance with the different parts of the Code in the 2005 financial year. The table shows that compliance with chapter II.2 (remuneration of management board members) lags behind the average. This also applies to chapter IV.

Overview of compliance with the code, by chapter

Chapter of the code	Compliance	Application	Explanation
I. Compliance with and enforcement of the code	97%	97%	0%
II. The management board			
II.1 Role and procedure	94%	90%	4%
II.2 Remuneration	79%	73%	6%
II.3 Conflicts of interest	99%	99%	0%
III. Supervisory Board			
III.1 Role and procedure	95%	95%	0%
III.2 Independence	95%	86%	9%
III.3 Expertise and composition	97%	92%	5%
III.4 Role of the chairman of the supervisory board and the company secretary	98%	91%	7%
III.5 Composition and role of three key committees of the supervisory board	98%	96%	2%
III.6 Conflicts of interest	95%	95%	0%
III.7 Remuneration	97%	92%	5%
III.8 One-tier management structure	100%	94%	6%
IV. Shareholders and general meeting of shareholders			
IV.1 Powers	89%	86%	3%
IV.3 Provision of information to and logistics of general meeting	91%	84%	7%
V. Audit of the financial statements and the position of the internal audit function and of the external auditor			
V.1 Financial statements	100%	100%	0%
V.2 Role, appointment and remuneration of the external auditor and assessment of his functioning	100%	100%	0%
V.3 Internal audit function	100%	83%	17%
V.4 Relationship and communication of the external auditor with the organs of the company	100%	100%	0%

Chapter I: compliance with and enforcement of the code

Chapter 1 of the code focuses on the manner of compliance and enforcement. The principle on which this chapter is based is that the management board and the supervisory board are responsible for the corporate governance of the company, and compliance with the code. They are accountable for this to the general meeting of shareholders. The chapter also contains two best practice provisions relating to

the corporate governance structure and changes to it. It is important in this connection for companies to clearly indicate in their annual report how the code is complied with.

The rates of compliance with and application of the best practice provisions of this chapter are high. Of all the companies together, only three local companies do not fully comply with the provisions.

The survey by the University of Groningen shows that for over 60% of the companies studied it is immediately and clearly evident from the annual report which provisions have not been complied with. In about 5% of the cases, reference is made in the annual report to a document that is available on the website. A further 5% of the companies refer to the 2004 annual report. A reference to this annual report implies that no changes have taken place since 2004.

In almost 25% of the cases, the information on compliance or non-compliance with the code is then less clear. Almost all these companies explain in the narrative of the report the points in respect of which they differ from the code. Three local companies do not comply with best practice provision I.1.

Chapter II: the management board

This chapter is divided into three parts, namely:

- i. role and procedure of the management board;
- ii. amount and composition of the remuneration of the management board members
- iii. conflicts of interest

Part 1 has seven best practice provisions, part 2 has fourteen and part 3 has four.

Part 3 of this chapter has the highest average compliance percentage (99%). Part 2 has an average compliance rate of approximately 80% and Part 1 of 94%.

All compliance percentages are higher than those of the 2004 financial year. Compliance with Part 2 – the amount and composition of the remuneration of management board members – has risen by 10 percentage points. Part 3 has achieved a slightly higher increase of 11 percentage points.

Despite the improvements since last year, compliance with two important parts of this chapter of the code is less than average. These are the provisions on internal risk management and control systems (II.1.3 and II.1.4) and on directors' pay (particularly II.2.9 and II.2.10).

Best practice provisions II.1.2 (approval by the supervisory board of operational and financial objectives and strategy) and II.3.2 (reporting of conflicts or potential conflicts of interest of management board members with interests of the company) are applied unconditionally by all the companies in the survey. This part of the code in fact contains the largest number of explanations for non-application. Almost half (313) of all explanations (666) are attributable to this part of the code. Compared with last year, the number of explanations of non-application has fallen by approximately 20% (total of 378 explanations in 2004). The decline in the number of explanations has resulted in a more unconditional application of the code.

Chapter III: supervisory board

This chapter has eight parts, namely

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

The rates of compliance in respect of all these parts are high, namely between 95% (III.1 and III.2) and 100% (III.8). The application rates are on average 4% lower.

Chapter IV, the shareholders and general meeting of shareholders

The great majority of this chapter of the code does not relate to the management board or the supervisory board. Part 2 of this chapter explains how shareholders deal with the code in practice. The parts covered here are Part IV.1 (the shareholders and general meeting of shareholders) and Part IV.3 (provision of information to the general meeting of shareholders).

The average compliance rates (89% and 91% respectively) are lower than the total average compliance rate of 96%. This lower average figure is caused in particular by the local companies, whose compliance rates are 84% for Part IV.1 and 75% for Part IV.3.

Chapter V, The audit of the financial reporting and the position of the internal audit function and of the external auditor

This chapter consists of four parts:

V.1 Financial reporting

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

V.3 Internal audit function

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

The average compliance and application rates in respect of the provisions of this chapter are 100% (the maximum).

All categories of company have a 100% compliance figure. The AEX companies have a 100% application figure in respect of all parts of this chapter. The AMX, AMS and local companies have a 100% application figure for Parts V.1, V.2 and V.4

Frequent explanations are given in respect of Part V.3, particularly by the local companies. This occurs in 33% of the cases. The corresponding figures for the AMS and AMX companies are 20% and 16% respectively

1.4 Explanation in the case of non-application of best practice provisions

This section deals with the explanation given in cases where best practice provisions are not applied. The researchers used by the Committee found a total of 666 instances (in annual reports or on websites) in which a company explained why it did not apply a best practice provision. This amounts to almost five explanations per company out of a total of 102 best practice provisions (ie, those relevant to this part of the report). It should be noted that a number of best practice provisions have various parts or sub-parts. For example, provision II 2.10 has twelve parts/sub-parts.

Ten best practice provisions whose non-application is most frequently explained (the following figures are absolute and the order follows the layout of the code)			
Provision	Summary	2005	2004
II.1.1	Maximum term of appointment of management board members	94	96
II.1.4	Statement concerning internal risk management and control	11	24
II.2.6	Regulations concerning ownership of and transactions in securities by management board members	52	49
II.2.7	Maximum severance pay	78	75
III.2.1	All supervisory board members except one are independent	17	24
III.3.5	Maximum term of office of 3 terms of 4 years for supervisory board members	18	24
III.4.3	Duties of company secretary	19	19
III.7.3	Regulations concerning ownership of and transactions in securities by supervisory board members	52	49
IV.3.1	Webcasts of analysts' meetings, presentations and press conferences for all shareholders	37	44
V.3.1	External auditor and audit committee involved in drawing up the work schedule of the internal auditor	15	27
Total number of provisions whose non-application is explained		423	457
Top-10 as percentage of the total		64%	68%

Two best practice provisions that were in last year's Top-10 of the most explained provisions have disappeared from this year's Top-10. These are the following provisions:

Provision	Summary	2005	2004
(in absolute numbers)			
II.2.10	Content of supervisory board's remuneration report	4	45
II.1.4	Declaration concerning internal risk management control systems	11	24

Quantitative analysis of the explanations shows that the reasons given by the companies can generally be reduced to a limited number of categories.

Nature of the reason given for not applying a best practice provision (in absolute numbers)					
Nature of the reason	AEX	AMX	AMS	Local	Total
Company wishes to respect existing agreements and/or contracts	21	30	32	52	135
Company asserts that legislation and regulations and/or case law prevent compliance	5	8	5	31	49
Company points out that the derogation is temporary and/or that it is in the process of implementing the best practice provision	7	7	10	16	40
Company points out that it has its own arrangement and states <i>explicitly</i> that this is in keeping with the spirit of the Dutch corporate governance code	5	3	2	1	11
Company points out that it has a different arrangement (and <i>merely</i> provides information about its own arrangement <i>without</i> giving further reasons).	17	18	17	29	81
Company considers that the provision requires a procedure that is not usual in the countries and/or sectors in which it operates	3	2	2	0	7
Company considers that the administrative and/or financial costs of implementing the best practice provision are unduly high and/or asserts that the company is too small to comply with the provision	4	6	19	89	118
The company considers that the provision concerns a field that is a private matter for the members of the management board or the supervisory board	2	0	3	11	16
Other reasons	33	27	39	110	209
Total	97	101	129	339	666

It can be concluded from the above that two categories of explanation predominate.

Explanation 1: '*Company wishes to respect existing agreements and/or contracts*'

The above explanation is the most common (135 times) in the case of derogation from the code. Clearly, this explanation involves a temporary element and implies that an expectation is created regarding the future application of the code. This explanation is used by each category of company to the same extent.

Explanation 2: *'Company considers that the administrative and/or financial costs of implementing the best practice provision are unduly high and/or asserts that the company is too small to comply with the provision.'*

The above explanation is used above all by local companies (75% of the total) and AMS companies (16%). This could be an indication that application of parts of the code is regarded by smaller companies as unduly burdensome. The explanation referred to above is often given in connection with three provisions:

- III.4.3 (company secretary);
- III.5 (key committees of the supervisory board) and
- IV.3.1 (webcasting).

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

At the Committee's request the researchers have explicitly studied the quality of the explanation. Hitherto no other European monitoring committees have analysed the content of the explanation. Consequently, there is no benchmark available. Clearly a degree of caution is necessary in assessing the results of a qualitative analysis without a benchmark.

It should be noted that the survey does not in any way detract from the general principle that it is for the shareholders to express an opinion on a departure from the code. The survey merely indicates how the explanation can be described. As the survey inevitably involves an element of subjectivity, the Committee believes that the results should be viewed with caution.

Research approach

The quality of the explanation is assessed by reference to four 'dimensions'. These dimensions were checked by two coders working independently of each other. In going through the dimensions, the coders worked systematically in accordance with a strict, predetermined job instruction. The coders were asked in this connection to adopt the attitude of a critical shareholder.

The technique employed by the University of Groningen for analysing the quality of the explanation is *content analysis*, a widely used academic technique for textual analysis. You can find a further explanation of content analysis in the research of the University of Groningen (see the Committee website for more information). The results of the analysis are dealt with below.

Dimensions studied

The dimensions studied in the survey are:

1. **Understandability:** this dimension involves checking whether the explanation given is understandable in the sense that it sheds light on why the company is not applying the provision.
2. **Verifiability:** this dimension involves examining whether the explanation given is verifiable with the help of information in the public domain (website, annual report, etc.).

In addition to the two objective dimensions mentioned above, there are also two subjective dimensions.

3. **Legitimacy:** this dimension involves assessing whether the explanation is regarded as a legitimate reason for not applying the relevant provision (*without* taking account of the specific characteristics of the company).
4. **Plausibility:** this dimension resembles 'legitimacy'. It classifies to what extent the interpretation is deemed to be plausible for the company taking account of the specific characteristics of the company (such as size, sector, activities, degree of internationalisation, etc.).

Understandability

The coders considered over 85% of the explanations to be understandable. Only one explanation is described as incomprehensible. Five percent of the explanations are classified as neutral. The coders differ as to whether the explanation is understandable in almost 9% of the cases.

Verifiability

This dimension covered the extent to which the coders considered the explanation given by the companies to be verifiable on the basis of information in the public domain (such as a website, annual report and so forth). The coders did not actually verify the explanation. The coders gave a positive opinion on the verifiability of the arguments used in 42% of the cases. In almost 12% of the cases both the coders took the view that the explanation was not verifiable. And in 5% of the cases they came to a neutral opinion on this dimension.

The coders agreed with each other in almost 60% of the cases. In almost 30% of the cases, one coder expressed a positive opinion while the other expressed a negative opinion. The difference in description primarily related to the argument that compliance with the best practice provision would entail unduly high financial and/or administrative costs, taking into account, for example, the size of the company. This was mainly the case where this argument was advanced for non-compliance with best practice provisions III.4.3 (concerning the assistance to be given to the supervisory board by a company secretary) and IV.3.1 (concerning webcasting). The coders also reached different conclusions about the motives given for non-compliance in respect of the 'other' category.

Legitimacy (this is a subjective dimension; the results are merely indicative)

The coders applied the legitimacy dimension in order to determine to what extent a given argument (ie, without taking account of the specific characteristics of a company) could, in a general sense, be regarded as a legitimate reason for not applying a best practice provision. In two thirds of the cases, the two coders agreed on the issue of legitimacy. In 45% of the cases they found the explanation to be legitimate. And in 16% of the cases their joint assessment was that it was not legitimate. Arguments belonging to the 'other' category were particularly likely to be treated as not legitimate, as were references to the size of the company and/or the financial and administrative burden. This was particularly the case if these arguments were advanced for not complying with best practice provisions II.2.6 and III.7.3 (rules on share transactions and share ownership by management board members and supervisory board members).

The coders had a different opinion about the legitimacy of the explanation in almost a quarter of the cases.

Plausibility (this is a subjective dimension; the results are merely indicative)

The coders applied the plausibility dimension in order to determine to what extent they regarded an argument as plausible. Specific account was taken of the characteristics of the company. The assessment of this dimension was very much in line with the assessment of the legitimacy dimension.

The above shows that it was difficult for the coders to distinguish between these two dimensions. This is confirmed in the part of the University of Groningen survey that deals with the arguments that caused the two coders to arrive at positive or negative assessments. One of the main arguments that both coders felt to be plausible was that the company wished to respect existing contracts (especially when used to explain why best practice provisions II.1.1 and II.2.7 are not applied). This was true of the argument that compliance with provisions III.4.3 (company secretary), III.5 (establishment of key committees of the supervisory board) and IV.3.1 (webcasting) would entail an unduly highly financial and/or administrative burden and/or was not feasible owing to the size of the company. Similarly, the arguments considered implausible by both coders tended to be the same as those they considered not legitimate. However, there was also a difference: both coders came to a negative opinion on plausibility if the reason given for non-application of best practice provisions II.2.6 and III.7.3 (regulations for management board members and the supervisory board members concerning share ownership and share transactions) was that this was a private matter.

The coders had a different opinion about the plausibility of the explanation in almost a quarter of the cases. Many of the cases on which they disagreed related to arguments classified as 'other reasons'. The results did not show that departure from one or more specific best practice provisions resulted in this difference of opinion.

Overview of the results of the analysis of the quality of the explanation:

Quality of the explanation (in percent)				
Dimension	Positive	Neutral	Negative	Unclear
Understandability	85	6	0	9
Verifiability	42	6	12	40
Legitimacy	46	6	16	32
Plausibility	45	6	15	34

Finally, it should be noted that the assessment of the quality of the explanation by reference to two other criteria, namely motive and temporariness, was included in section 1.4.

1.6 Non-compliance with code provisions

Despite the legal force of the code, provisions are not always complied with. The average non-compliance rate per code provision is 4%⁶.

Compliance with a number of best practice provisions is clearly below average. The provisions listed in the table below are provisions in which non-compliance (of part of the provision) was identified in over ten individual cases.

Best practice provisions most often not complied with (in absolute numbers)					
Provision	Summary	AEX	AMX	AMS	Local
II.1.3	Presence of internal risk management and control system: information in public domain	0	1	7	21
II.1.4	Declaration concerning internal risk management and control systems	1	2	2	13
II.1.5	Report on sensitivity of results to company to external factors	0	0	0	13
II.2.1	Options are granted only conditionally	0	2	3	8
II.2.6	Regulations concerning ownership of and transactions in securities by management board members	0	0	3	7
II.2.9	Remuneration Committee report	5	2	4	14
II.2.10	Overview of remuneration policy	2	3	3	14
II.2.11	Disclosure of main elements of management board members' contracts	5	2	0	5
III.1.3	Profile of members of supervisory board**	--	--	--	--
III.1.7	Performance of supervisory board	1	1	3	16
III.1.8	Discussion of strategy by supervisory board	6	3	6	15
III.3.1	Profile of composition of supervisory board	1	1	0	12
IV.1.4	Policy on dividends and additions to reserves dealt with as a separate agenda item in general meeting	2	0	5	16
IV.1.5	Resolution to declare dividend dealt with as a separate agenda item in general meeting	2	1	2	9
IV.3.1	Webcast of analysts' meetings, presentations and press conferences for all shareholders	0	1	2	19
IV.3.9	Publication of use of anti-takeover measures	1	1	2	9

*) The overview referred to in II.2.10 contains 12 parts; the figures in the table are average figures for all separate parts.

***) This is an average of parts of provisions.

Non-compliance with best practice provisions (or parts thereof) occurs most frequently among the local companies.

⁶ A non-compliance rate of 4% means that in each category of company one or two companies do not comply with the best practice provision.

1.7 Code provisions explained in more detail

This section deals in greater depth with code provisions that are most frequently explained or are not complied with relatively often. These categories include code provisions II.1.3 and II.1.4 concerning internal risk management and various code provisions from chapter 2 concerning the remuneration of management board members. Compliance with these provisions of the code is dealt with in section 1.8 (II.1.3 and II.1.4) and section 1.9 (chapter II.2).

Code provision II.1.1

Best practice provision II.1.1 states that a management board member is appointed for a maximum term of four years. It also provides that a member may be reappointed for a term of not more than four years at a time. Eight companies did not comply with this provision. A further 95 companies explained why they did not apply this best practice provision. Explanations were given mainly by AMX companies (18 of the 22 AMX companies), AMS companies (21 of the 25 AMS companies) and local companies (44 of the 56 local companies). The relatively large number of AEX companies is also noteworthy (12 of the 24).

Code provision II.1.5

This provision deals with reporting by the management board on the sensitivity of the results of the company to external factors and variables. While all AEX, AMS and AMS companies comply with this provision, 13 local companies failed to do so (without offering an explanation).

Code provision III.1.3

The application of this provision of the code means that the report of the supervisory board lists various facts and circumstances in relation to individual members of the supervisory board, namely sex, age, nationality, occupation, principal job, relevant second jobs, date of appointment and the term for which he or she has been appointed. The two items of information most frequently omitted are sex and nationality. The omission of the sex makes it hard to determine how many members of supervisory boards are women.

Code provision III.1.5

Provision III.1.5 states that the report must mention supervisory board members who are frequently absent. A majority of all companies applied this provision (92 of 123 companies, or 75%). It was mainly the local companies that did not apply this provision (20 of the 52). 5 (23%) and 6 (24%) of the AMX and AMS companies respectively did not apply this provision.

Code provision III.1.7

Provision III.1.7 stipulates that the supervisory board should discuss its own functioning and the functioning of the management board, and that it should include its findings in its own report. This provision is applicable to 123 (report on own functioning) and 122 (report on functioning of management board members) of the 127 companies in the survey. The great majority of companies complied with this provision. However, a relatively large number of local companies did not apply this provision: 12 did not do so in relation to reporting by the supervisory board on its own functioning while 16 did not do so in relation to reporting by the supervisory board on the functioning of management board members. This amounts to 25-30% of the local companies.

Code provision II.1.8

According to provision III.1.8, the supervisory board should discuss the corporate strategy, the business risks, and the result of the assessment by the management board of the structure and operation of the internal risk management and control systems, and that it should mention these in its report.

Much the same picture as above is found in relation to compliance with this provision. While most of the 123 companies applied this provision, it was mainly the local companies that failed to do so. Primarily missing from the report of the supervisory board were (i) the risks (10 out of 51 cases) and (ii) a discussion of the assessment of the risk management and control system by the management board (15 out of 51 cases). Discussion of the management board's assessment was also missing in a number of cases for the other companies. This was true of 6 of the 24 AEX companies, and 6 of the 25 AMS companies.

Code provisions III.2.1 and III.2.3

According to provision III.2.1, supervisory board members should be independent. The provision states that an exception to the requirement of independence may be made for a maximum of one supervisory board member. Provision III.2.3 stipulates that the report of the supervisory board should state that best practice provision III.2.1 has been fulfilled. In addition, it should also mention which supervisory board member, if any, is regarded by the board as not being independent.

It is noteworthy that a fairly large number of companies applied the provisions by explicitly explaining their non-compliance with one or both of the provisions. This is true of 15 companies (half of them local) in the case of provision III.2.1 and 8 companies in the case of provision III.2.3. Ten companies did not apply the latter provision; once again, the majority of them (6) were local companies.

Code provisions III.3.1 and III.3.5

The composition of the supervisory board must be such that it is able to carry out its duties properly. Best practice provisions III.3.1 to III.3.6 concern the profile, composition, introduction, number of supervisory board memberships, term of appointment and number of terms, and retirement schedule.

Best practice provision III.3.1 states that the supervisory board must prepare a profile of its size and composition. This provision was not observed by 14 companies (12 of them were local companies).

Best practice provision III.3.5 states that a person may be appointed to the supervisory board for a maximum of three four-year terms. An explanation of non-application was given by 18 companies. Eight of them were local companies; moreover, two local companies did not comply with this provision.

Code provision III.4.3

Best practice provision III.4.3 concerns the assistance to be provided to the supervisory board by a company secretary. In addition, this best practice provision contains a number of rules concerning the duties of the company secretary. A total of 22 companies gave an explanation of why they did not apply this best practice provision. 15 of them were local companies. Virtually all of these companies employed a single argument in this connection: the size of the company was not sufficient to warrant the appointment of a separate company secretary. Six of the 125 companies to which this provision is relevant (4 being local companies) did not comply with it.

Code provision III.7.3

This best practice provision concerns the adoption of a set of regulations containing rules governing ownership of and transactions in shares by supervisory board members. 27 companies gave an explanation of why they did not apply this provision. This is almost 50% less than in the 2004 financial year.

Six of the 111 companies to which this provision was relevant did not comply with it

Code provisions IV.1.4 and IV.1.5

These code provisions concern the inclusion of separate items on the agenda of the general meeting for:

- policy on reserves and dividends (IV.1.4), and
- the resolution for the declaration of dividend.

2 AEX, 5 AMS and 17 local companies did not apply provision IV.1.4. One of the 17 local companies explained why it did not do so. A comparable situation exists in relation to compliance with and application of provision IV.1.5.

Code provisions of part IV.3

Finally, there are a number of provisions relating to the provision of information to the general meeting of shareholders (part IV.3). More specifically, consideration is given to IV.3.1 (meetings and presentations are announced in advance on the company's website, may be followed by shareholders in real time and are subsequently posted on the company's website) and IV.3.9 (survey of all existing or potential anti-takeover measures in the annual report).

First of all, it transpires that the AEX, AMX and AMS companies generally applied the provisions, although it should be noted that half of the AMS companies did not comply with provision IV.3.1, instead offering an explanation of why this was so. In the case of the local companies, the picture differs from that of the other three indices. No fewer than 19 of the 56 companies (34%) did not apply provision IV.3.1 while a further 25 companies (46%) explained the reason for their non-compliance. The degree of divergence was less in the case of the other provisions discussed here. Nonetheless, 16 of the 56 companies (29%) did not apply provision IV.3.7 and 9 of the 53 companies (17%) did not apply provision IV.3.9.

Code provision V.3.1

This provision concerns the involvement of the external auditor and the audit committee in drawing up the work schedule of the internal auditor. It is complied with by all companies, even though 22 companies achieve this by explaining why they do not apply it. 70% of the companies concerned are local.

1.8 Internal risk management and control systems

Provisions of the code and recommendations of the Committee

The management board is responsible for the adequate functioning of risk management and control systems. The Code elaborates this responsibility in best practice provisions II.1.3 and II.1.4.

- II.1.3 The company shall have an internal risk management and control system that is suitable for the company. It shall, in any event, employ as instruments of the internal risk management and control system:*
- (a) risk analyses of the operational and financial objectives of the company;*
 - (b) a code of conduct which should, in any event, be published on the company's website;*
 - (c) guides for the layout of the financial reports and the procedures to be followed in drawing up the reports;*
 - (d) a system of monitoring and reporting.*
- II.1.4 The management board shall declare in the annual report that the internal risk management and control systems are adequate and effective; it shall provide clear substantiation of this. In the annual report, the management board shall report on the operation of the internal risk management and control system during the year under review. In doing so, it shall describe any significant changes that have been made and any major improvements that are planned, and shall confirm that they have been discussed with the audit committee and the supervisory board.*

The Committee considered it desirable in its first report to make recommendations concerning the application of best practice provision II.1.4. In this case, the Committee talks of *good practice*. The Committee considers that best practice provision II.1.4 is fulfilled if:

1. as regards financial reporting risks:

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

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

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

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

The key question in this section is to what extent the recommendations of the Committee have resulted in an improvement in compliance with the provisions of the code.

To answer this question, the University of Groningen has examined what parts of the best practice provisions – supplemented by good practice recommendations – are applied, explained or not complied with. The Committee has also raised the subject of internal risk management and control systems in meetings with accountants/auditors.

Main findings

It was indicated in part 1 of this chapter (compliance with the code) that best practice provision II.1.4, as interpreted by the good practice of the Committee, is no longer in the category of frequently explained best practice provisions. Whereas 24 explanations were given in relation to this provision in 2004, the number fell sharply to 11 in 2005. A total of 12 companies explained why they did not apply best practice provision II.1.3. However, both provisions still belong to the least-complied-with provisions. Compliance with individual best practice provisions is dealt with below.

Best practice provision II.1.3

98 of the 127 companies in the survey do not comply with this provision. The aspect of the provision not complied with by companies is the requirement that a code of conduct be placed on the company's website. 29 companies have not placed a code of conduct on their website. Of the 29 companies, 21 are local companies, 7 are AMS companies and 1 is an AMX company.

A total of 14 companies give an explanation for non-application of one or more parts of this provision (1 AMX, 1 AMS and 12 local companies). 9 companies (1 AMS and 8 local) explain why they do not place a code of conduct on their website. One AMS company additionally explains why no guide is available. Local companies also explain the non-application of other parts of the provision: the absence of a risk and control system is explained in 2 cases, the absence of risk analyses in 3 cases, the absence of a guide also in 3 cases, and the absence of a monitoring and reporting system in 1 case.

Best practice provision II.1.4

86 of the 124 companies that have a risk management and control system as referred to in II.1.3 issued a statement that the risk management and control systems provide a reasonable assurance that the financial reports do not contain any errors of material importance. 7 companies issued an explanation and 31 made no statement (1 AEX, 3 AMX, 2 AMS and 25 local companies).

In total, 84 of the 121 companies issued a statement that the risk management and control systems had worked properly in the year under review. 6 companies gave an explanation of non-application and 31 companies failed to comply with this provision (2 AEX, 4 AMX, 3 AMS and 22 local companies).

As regards the financial reporting, the part that is least complied with is the statement that there are no indications that the risk management and control systems will not function properly in the current year (the so-called forward-looking statement). 49 companies gave an explanation of non-application of this part of the provision (5 AEX, 5 AMX, 5 AMS and 34 local companies).

The recommendation that any deficiencies which (i) might have material consequences and (ii) were discovered in the year under review or the current year, as the case may be, should be disclosed was applied by 118 of the 121 companies. This means either that no deficiencies were discovered or that any deficiencies were disclosed. Of the companies that disclosed deficiencies, 1 did not indicate what improvements had been made and 2 did not report planned improvements.

99 of the 121 companies provided a description of the operational and strategic risks. 2 of them gave an explanation of non-application and 20 (including 15 local companies) did not provide a description.

76 of the 121 companies gave a description of the risks of legislation and regulation. 2 of them explained why they had not given a description and 43 (including 7 AMX, 10 AMS and 23 local companies) did not give a description.

1.9 Remuneration of management board members

The provisions of the code dealing with the remuneration policy in relation to management board members are mainly contained in part II.2 of the code. Like last year, the rate of compliance with and application of this part of the code is lower than that of other parts of the code. This section therefore deals with compliance with the provisions of this chapter. Chapter 2 of this report subsequently goes on to deal in greater depth with the subject of remuneration and remuneration policy.

Remuneration report

Provision II.2.9 stipulates that the remuneration report should contain an account of the manner in which the remuneration policy has been implemented in the past financial year (ie, 2005), and of the remuneration policy for the next financial year and subsequent years. It transpires that 119 of the 127 companies published the remuneration report for the financial year in the annual report or on the website. No report was found on eight occasions, each of them involving a local company.

115 of the 119 companies referred to above described the remuneration policy in 2005; the other four companies explained why they did not. Future remuneration policy was discussed by 97 companies. The others explained why they did not apply this provision.

Non-variable remuneration

Best practice provision II.2.10 concerns the content of the remuneration report of the supervisory board. The first three parts of this best practice provision concern the non-variable remuneration.

- The first part concerns the statement of the relative importance of the variable and non-variable remuneration components and the substantiation thereof. This provision applies to all companies. 112 companies indicated the relative importance of the variable and non-variable part of the remuneration, and 71 also explained this.
- The second part concerns the explanation of any absolute change in the non-variable remuneration component. Such a change occurred in the case of 78 listed companies. Although the code does not formulate any rules governing the absolute amount of the remuneration, it is nonetheless worth mentioning that over one third of the companies did not change the fixed remuneration component. 28 of the 78 companies which changed the fixed remuneration component in the financial year did not comply with the best practice provision. This mainly concerned local companies (22 in total).
- The third relevant part of best practice provision II.2.10 concerns information about the peer group, ie, the group of companies that serve as a frame of reference for the formulation of the remuneration policy. The peer group was mentioned by 70 companies. It is striking that 29 of the 48 local companies to which this part of the best practice provision is relevant did not comply with it. Non-compliance was also the conclusion drawn in a substantial number of cases in respect of the AMS companies (9 out of 24) and AMX companies (7 out of 21).

Options and shares

Options are dealt with in best practice provisions II.2.1, II.2.2, II.2.4, II.2.5 and II.2.14. Part II.2.3 deals with the granting of shares without financial consideration.

- Provision II.2.1 concerns the granting of conditional options to management board members as a remuneration component. 61 of the 127 listed companies granted conditional options as part of the remuneration of management board members. 48 of the 61 companies complied with this best practice provision; 41 of the 48 applied the provision and 7 did not do so but explained why. 13 companies did not comply with this provision (8 of them were local companies).
- Provision II.2.2 concerns the situation in which two conditions are imposed when otherwise unconditional options are granted by a company (notwithstanding II.2.1), namely the application of performance criteria and a requirement that the options be held for a minimum of three years. 17 listed companies granted unconditional options.
- Best practice provision II.2.4 stipulates that the exercise price of options should be verifiable. 61 companies had an option scheme. 50 of them applied the provision and one gave an explanation. Ten companies did not comply with the best practice provision.
- Best practice provision II.2.5 stipulates that neither the exercise price nor the other conditions regarding the granted options may be modified during the term of the options, except in so far as necessitated by structural changes relating to the shares or by market conditions. Once again, the provision was relevant to 61 of the 127 companies. 57 of the 61 companies reported that the conditions and the term had not been changed. 4 companies reported changes. 3 of the 4 companies mentioned the reason for the change, and the fourth did not do so even though it did explain why it diverted from the provision.
- Best practice provision II.2.14 concerns the requirement of transparency in relation to options granted by a listed company to management board members and other staff. Under this provision, the company should provide information on the value of the options granted and on how this value is determined. Only nine companies to which this provision was relevant failed to provide information about the value of the options. Seven companies failed to comply with the part of the provision requiring the provision of information about the determination of value. An explanation was given in only one case.
- Best practice provision II.2.3 concerns the granting of shares to management board members without financial consideration. 48 of the 127 companies granted shares without financial consideration as part of their remuneration policy. Virtually all companies with a share scheme applied the best practice provision.

Contract term, periods of notice and severance schemes

Provisions relating to the term of employment contracts, periods of notice and severance schemes are recorded in II.2.10 and II.2.7.

A total of 113 of the 127 companies in the survey provided information about the term of the employment contract of management board members. Relatively little information was provided about

the applicable periods of notice for termination of management board positions. In general, severance schemes were described more frequently (by 91 companies) and, albeit to a lesser extent, justified (by 63 companies).

Provision II.2.7 indicates that the maximum severance pay is one year's salary in the event of dismissal of a management board member, or twice the annual salary in the case of a management board member dismissed during his first term of office. The survey by the University of Groningen shows that 120 companies had a redundancy scheme. The majority of the companies complied with this provision. Five of the companies did not comply with this best practice provision; strikingly, three of them were AEX companies. In the great majority of cases compliance with this provision consisted of explaining that the code was not applied.

Other remuneration components

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

- Best practice provision II.2.8 states that a company may not grant its management board members any personal loans or the like unless three specified conditions are fulfilled. 101 of 127 listed companies operated a policy that no loans would be granted. Only 26 companies (mainly AEX, AMX and AMS companies) did grant personal loans.
- Part II.2.10 of the code relates, among other things, to the provision of information about agreed schemes for the early retirement of management board members. 111 of the 122 companies in the survey to which this aspect was relevant provided such information. A relatively large number of the local listed companies (10 of the 51) did not comply with this provision.
- Best practice provision II.2.12 concerns the payment of special remuneration to members and former members of the management board. Under this provision a company is obliged to include in the remuneration report an explanation of the reasons for granting such remuneration. Only 14 of the listed companies had paid special remuneration of this kind. In almost all cases, these companies explained the payment concerned in the remuneration report. This provision was not complied with in only two cases.

Performance criteria

Best practice provision II.2.10 includes a requirement that the performance criteria for the variable remuneration component should be described.

This provision of the code requires the following:

- a. a description of the performance criteria on which any right of the management board members to options, shares or other variable remuneration components is dependent;
- b. a summary of the methods that are applied in order to determine whether the performance criteria have been fulfilled;

- c. if the performance criteria are based on external factors, a summary of the factors used to make the comparison (for example the peer group or index).
- d. a description and explanation of each proposed change to the conditions on which a management board member can acquire rights to variable remuneration components.

A relatively large number of AMX companies (4) and local companies (17) failed to provide a description of the performance criteria and did not comply with the provision. An even larger number of companies failed to provide a summary of the methods applied in order to determine whether the performance criteria had been fulfilled. The above applies to all categories. It was also true of part (c) referred to above. Compliance with part (d) was relatively good.

1.10 Compliance with the code by foreign companies

As indicated previously, the code applies to all companies that are listed on a stock exchange and have their registered office in the Netherlands. It follows that the code also applies to Dutch-registered companies that are listed only on foreign stock exchanges and do not enter the Dutch capital market (foreign companies). On the other hand, the code does not apply to companies that have a registered office abroad and a listing on Euronext Amsterdam.

Many companies that fall within the category of *foreign* companies confine themselves in practice to giving a general explanation of their compliance with the code. The explanatory notes to the Royal Decree to formulate additional provisions regarding the content of the annual accounts provide the required leeway.

In fact, the survey by the University of Groningen examines Dutch companies that are listed only abroad as well as foreign companies that are active in the Dutch capital market. As the code only applies to companies in the first category, the Committee has confined itself to information in relation to this category.

The results of the survey can be summarised as follows:

<i>Description of compliance with the code</i>	Foreign companies
Company state explicitly that the Dutch corporate governance code is not applicable, possibly adding that the company complies with a foreign code.	0
Company merely states that a foreign code is applied. Makes no mention of the Dutch corporate governance code.	0
Company reports that both the Dutch corporate governance code and a foreign code are applied, but makes no further reference to compliance with the Dutch corporate governance code.	3
Company reports that both the Dutch corporate governance code and a foreign code are applied, and provides information about this.	5
Company provides no information whatever about compliance with corporate governance codes.	1
Total number of companies in survey	9

1.11 Points for attention

The survey of compliance with the code by listed companies shows that there has been a marked improvement in compliance since the previous financial year. The average compliance rate of 96% is high, but there are nonetheless some parts in respect of which compliance could still be improved. The following specific points can be made:

- Despite the high rate of compliance with the code, the Committee points out that compliance should be 100%. This does not mean that the Committee takes the view that all provisions of the code should be applied unconditionally. Departures from the code are possible provided this is made apparent by means of an explanation.
- Local companies lag behind the AEX, AMX and AMS companies in terms of compliance with the code. The poorer compliance with the code by these companies cannot be explained by their smaller size. The provision of an explanation in the event of a departure from the code (irrespective of the size of the company) is always possible. The Committee is, incidentally, prepared to examine what parts of the code are unnecessarily onerous in relative terms for local companies. The Committee has drawn up specific consultation questions for this purpose.
- 85% of the explanations given for departures from the code are classified as *understandable*. Whether the explanation given is verifiable (by reference to information in the public domain) is assessed as positive or neutral in 47% of the cases. The assessment is negative in 12% of the cases. In the remaining cases, it is not possible to give a clear view on whether the explanation is verifiable. The Committee calls on companies to give explicit consideration in the next financial year to ensuring that any explanation given is understandable and verifiable. An explanation qualifies as sound if it is understandable and verifiable at all times.

2. Activities of shareholders

2.1 Introduction

Paragraph 3 of the preamble to the code explains that a company is a long-term form of collaboration between the various stakeholders. The management board and the supervisory board have overall responsibility for weighing the interests of all stakeholders. Good entrepreneurship (including integrity and transparency of decision-making by the management board) and proper supervision thereof (including accountability for such supervision) are essential if the stakeholders are to have confidence in the company.

It is up to the shareholders of the company to call the management board and the supervisory board to account in respect of compliance with the code. Both the content of the chapter of the annual report dealing with the company's corporate governance structure and corporate governance policy and the statement on compliance with the best practice provisions can be raised each year in the general meeting of shareholders, at the initiative of the management board or one or more shareholders.

Shareholders play an important role when it comes to enforcing the system of checks and balances in the company. Decisions of the management board on major changes in the identity or character of the company should be approved by the meeting of shareholders. This part explains how companies and shareholders deal with the code in practice, particularly as far as general meetings are concerned. Section 2.2 describes the survey carried out by Rematch on behalf of the Committee. After consideration of the design of the survey, the section examines the findings. Section 2.3 examines the influence of general meetings on companies. Section 2.4 deals with the meeting of shareholders. Various aspects are analysed in this context. Section 2.5 examines the use of anti-takeover defences and the issuing of depositary receipts. Section 2.6 deals with the meeting of shareholders. Finally, section 2.7 lists a number of points for attention.

2.2. Approach

To assess the activities of shareholders in 2005, the Committee commissioned a survey by Rematch. This survey examined 83 listed companies and 66 institutional investors. The analysis examines various aspects such as:

- the functioning of the general meeting of shareholders;
- the influence of general meetings on companies;
- analysis of anti-takeover measures and issuance of depositary receipts for shares; and
- the role of institutional investors.

2.3 Influence of general meetings on companies

(a) Attendance rates

If shareholders are to exert influence at general meetings, it is essential that they be present or represented. A criterion for this is the attendance rate of those entitled to vote at general meetings. The average attendance at general meetings of companies is 56%. This figure is scarcely higher than last year's average attendance rate (54%).

Like last year, the AEX companies have a lower average rate of attendance (44%) than AMX companies (53%), AMS companies (63%) and local companies (65%). If companies that have issued depositary receipts for shares are disregarded (they have an average attendance rate of 97%), the average attendance rates are:

- 44% for all companies in the survey;
- 36% for AEX companies;
- 39% for AMX companies;
- 45% for AMS companies; and
- 56% for local companies.

The average attendance figures in 2006 are comparable to the 2005 and 2004 figures.

(b) Raising corporate governance issues

Putting corporate governance on the agenda

Companies account for the chosen corporate governance structure and compliance with the code in the annual report. This issue is covered during the general meeting.

Best practice provision 1.2 of the code provides (by way of addition to the above) that each substantial change in the corporate governance structure of the company and in the company's compliance with the code must be submitted to the general meeting of shareholders for discussion as a separate agenda item.

In 2006 over half of the companies in the survey did not mention corporate governance as a separate agenda item for the general meeting. By way of comparison, 90% of the companies did mention corporate governance as a separate agenda item last year. This year the figure is 39%. The survey also shows that in eight cases shareholders requested that corporate governance be included as a separate agenda item.

Of the 39% of companies that put corporate governance on the agenda as a separate item, 16% dealt with this item before the agenda item concerning the discharge of the management board from liability for its conduct of the company's affairs.

The Committee believes that items concerning the annual report and corporate governance should be raised before the agenda item concerning the discharge of the management board from liability for its conduct of the company's affairs. The reason for this is clearly described in paragraph 8 of the preamble to the code. This states as follows:

'If the general meeting of shareholders (or part of the general meeting) objects to the corporate governance structure and/or the reason given for non-application of one or more best practice provisions, it may exert pressure, both in the general meeting of shareholders and otherwise, on the management board and the supervisory board to alter the corporate governance structure and/or observe the provisions of the code better. [...]. If the discussion between the general meeting of shareholders or a group of shareholders on the one hand and the management board and supervisory board on the other with regard to an important question should nonetheless become deadlocked, the shareholders may exercise the rights available to them (both in the general meeting of shareholders and otherwise).

In the general meeting, shareholders may exercise the right not to discharge the management board from liability for its conduct of business and the supervisory board from liability for its supervisory tasks, to alter the policy on remuneration, and to dismiss the supervisory board and/or the management board. In addition, they may take various types of legal action, such as starting an inquiry or annual accounts procedure.'

An alternative route for presenting changes in the corporate governance regime to the general meeting of shareholders is to have an explicit vote on departures from the code during the meeting. This route is recorded in paragraph 7 of the preamble to the code. Eight companies offer this possibility.

Questions and comments about policy and corporate governance

Most questions and comments put forward by shareholders concerned:

1. corporate governance (22%). Questions on the remuneration of management board members predominated. Over 40% of the corporate governance questions and comments (ie, 9% of the total) related to this. The proportion of questions and comments on internal risk management within the corporate governance category amounted to almost 24% (ie, 5% of the total number of questions and comments).
2. implementation of the business plan (18%);
3. annual accounts (11%).

Questions on corporate governance were also put during general meetings, even where corporate governance was not a separate agenda item. In 2006, a total of 713 questions about corporate governance were put during general meetings. Of these, 323 (45%) related to the code. Last year, 400 questions about the code were put (this number covers the companies in the survey).

The AEX companies received the highest percentage of questions about the code (63%) while AMS companies received the fewest (6%). The AMX companies occupied an in-between position (33%). This year the AEX companies have accounted for 69% of all questions about the code (compared with 42% in 2005).

(c) Voting behaviour of shareholders

A large proportion of the agenda items⁷ at general meetings are voted on by the shareholders. The number of items on which shareholders could vote was 842 this year (compared with 798 in 2005). This was an average of 10 votes in each general meeting. One or more votes were cast against the resolution in the case of 45% of the votes. This percentage has barely changed since last year. The percentage of agenda items on which one or more votes were cast against the resolution was higher in the case of AEX companies - 75% compared with 87% in 2005. Lower percentages were recorded in the case of:

- AMX companies: 39%
- AMS companies: 26%
- Local companies 21%

In most of the above-mentioned cases, the percentage of votes cast against the resolution in 2006 was under 1% of the total number of votes cast. However, the percentage of votes against the resolution is higher than 1% in a number of fields, namely:

- authorisation for the issue of shares (average percentage of votes cast against the resolution): 10% (in 2005: 13.01%)
- exclusion of shareholders' right of pre-emption: 6.03% (in 2005: 12.6%)

⁷ These are agenda items that may be voted on (other than by acclamation).

- policy on remuneration of management board members (average percentage of votes cast against): 2.75% (in 2005: 6.96%)
- remuneration of management board members: 2.77% (in 2005: 1.57%)

As a supplement to the above overview, it can be noted that the average percentage of votes cast against a resolution (in the case of agenda items for which one or more votes were cast against the resolution) fell from 2.9% in 2005 to 1.8%.

(d) The involvement of the external auditor in the general meeting

The auditor was explicitly introduced during the general meeting in the case of almost three quarters of the companies in the survey. This occurred at 86% of companies in 2005.

In 2006, 26% of companies indicated that questions could be put to the external auditor. However, there were major differences between the categories of listed companies in the survey. The AEX companies had the highest average percentage (65%). By contrast, the AMX companies had the lowest (32%). It is also striking that these percentages were significantly higher in 2005. On average, 82% of companies indicated that questions could be put to the external auditor in 2005.

The total number of reactions and comments from the external auditor was negligible. In all there were 20 reactions/comments. This is a third lower than last year.

(e) Special meetings of shareholders

In total, 22 special meetings of shareholders were held in the period from 1 September 2005 to 1 September 2006. By the end of September, minutes were available for 10 of these meetings and lists of resolutions for three.

Special meetings of shareholders were primarily held for the following reasons:

- appointment or reappointment of a management board member (7 times);
- alteration of articles of association (4 times); and
- merger/takeover (4 times).

Compared with the previous survey period, the number of special meetings more than doubled.

2.4 General meeting of shareholders – further analysis

At the request of the Committee, the researchers have paid specific attention this year to the preparation of the general meetings of shareholders. This section reviews the most important functions of the general meeting, and how the meeting is prepared.

(a) The general meeting – formal framework

By law, the general meeting has a decision-making function. The usual topics on the agenda of the general meeting are:

1. appropriation of profit;
2. approval of the annual accounts;
3. adoption of the annual report;
4. granting of a discharge to the members of the management board and supervisory board;
5. appointment and dismissal of the members referred to in 4 above; and
6. granting of authorisation to the management board to issue and/or buy shares of the company (within certain limits).

The central document at the meeting of shareholders is the annual report. The annual report deals with the accountability of the management board for the company's policy and of the supervisory board for its supervision of this policy. It also provides information about the future prospects of the business.

(b) Prior to the general meeting

An important subject is the so-called pre-general meeting stage (pre-AGM stage).

The following elements can be identified in the pre-AGM stage, partly by reference to the survey carried out independently by the Committee⁸:

- **Publication of annual results:** the annual results are published some time prior to the general meeting. Many companies explain the annual results at a **presentation for analysts/press conference**.
- **Road show:** as a supplement to the presentation for analysts and the press, many companies organise a road show to explain the results to other interested parties, mainly consisting of large professional investors. The nature of the meetings varies from **one-on-ones** to meetings for small groups of investors.
- **Publication of agenda of general meeting:** this stage is geared more closely to the actual general meeting in organisational terms. The agenda is drawn up and published. The meeting is called by means of advertisements in daily newspapers.

⁸ See the Committee website www.commissiecorporategovernance.nl for the results of the questionnaire commissioned by the Committee concerning the functioning of the general meeting.

The reactions to the questionnaire on the role of the shareholders reveal that:

- A majority of the companies arrange for the dialogue with individual shareholders to be conducted by the management board (usually the chairman of the board and the CFO) and/or the director of Investor Relations (IR).
- The role of the chairman of the supervisory board is generally confined to the general meeting or to conflicts of interest involving the management board.
- Most companies state that they do not consult individual shareholders in advance about strategic decisions, but they do listen to the opinion of individual shareholders. Investors confirm this view. The majority of the companies state that consulting shareholders will be desirable and/or inevitable in the future.

(c) the general meeting itself

The following elements are common to most general meetings:

- the chairman of the supervisory board opens the meeting on behalf of the company; in his opening address, the chairman often deals with matters of organisation for the meeting (voting procedures, speaking time, etc.);
- the chairman of the management board usually gives a presentation;
- thereafter the items on the agenda are dealt with.

The survey conducted by Rematch explicitly examined the content of the presentation given by the chairman of the management board. The following points can be made about this:

- implementation of the business plan was dealt with in 86% of the cases;
- the annual accounts were included in the presentation in 71% of the cases;
- the subject of corporate governance was often not touched upon in presentations (dealt with in only 17% of the cases);
- the remuneration of management board members was discussed in 1% of the presentations.

Owing to the increasingly international composition of the management boards of Dutch companies and of the shareholder base, general meetings are increasingly conducted in English.

2.5 Anti-takeover measures and issuance of depositary receipts for shares

Changes in control structure

In comparison with last year's survey, nine companies have reported formal changes in the control structure.

- In the case of three companies this involved changes to the following measures:
 - a) abolition of the so-called 1% scheme following the termination of the anti-takeover nature of the depositary receipt scheme;
 - b) increase in the right to issue preference shares as an anti-takeover device (from 50% to 100% of the outstanding amount of ordinary shares and, if applicable, preference shares).
- Two companies abolished their priority shares or anti-takeover preference shares, as the case may be.
- Two companies terminated the issue of depositary receipts for shares.
- The special share of the State was abolished in the case of one company.
- A single company amended the authority of the management board to choose its own chairman by providing that the management board and supervisory board would jointly choose the chairman of the management board.

Trust offices

As regards the documentation made available by trust offices, the main changes in relation to 2005 can be summarised as follows:

- the minutes of the meeting of shareholders of the companies concerned are always present at the trust offices (compared with 63% of cases in 2005);
- the availability of the constitutions of the trust offices (on the websites of the companies concerned) fell from 92% in 2005 to 79% in 2006;
- the independence of the management board was explicitly discussed in the case of four trust offices (compared with two cases in 2005);
- a meeting of holders of depositary receipts for shares could be called in 11 companies (compared with 8 companies in 2005).

It can be inferred from the Rematch survey that the interests of depositary receipt holders are represented to a more significant extent. This year, twelve out of fifteen trust offices primarily focused on the interests of the depositary receipt holders (compared with six in 2005). Moreover, voting proxies were granted without limitations by twelve out of fifteen in 2006 (compared with six in 2005).

2.6 Institutional investors

Chapter IV.4 of the code relates to the responsibility of Dutch institutional investors. It is assumed in the code that these institutional investors act primarily in the interests of their ultimate beneficiaries or investors. According to the code, institutional investors have a responsibility to their ultimate beneficiaries to decide, in a careful and transparent way, whether they wish to exercise their rights as shareholder of listed companies⁹.

Chapter IV.4 contains three best practice provisions:

- Provision IV.4.1 states that institutional investors must publish annually (in any event on their website) their policy on the exercise of voting rights for shares they hold in listed companies.
- Provision IV.4.2 requires institutional investors to report annually (on their website and/or in their annual report) on how they have implemented their policy on the exercise of voting rights.
- Provision IV.4.3 requires institutional investors to announce (via their website) at least once a quarter how they have actually voted in general meetings.

This year, 66 institutional investors were included in the survey (compared with 20 last year). The survey distinguishes between two categories of institutional investors for which compliance with the code is relevant, namely (i) pension and investment funds and (ii) banks and insurers.

In addition to the two categories mentioned above, the survey covers foreign institutional investors. Foreign institutional investors play a dominant role in the Dutch capital market. Research has shown that 75% of the capital invested in companies listed on Euronext Amsterdam comes from abroad.

The average compliance percentage achieved by institutional investors is nearly 30%.

General information about corporate governance

45% of the institutional investors in the survey had general information about corporate governance on their own website. The figures for each sub-category were as follows:

- pension and investment funds: 58%.
- banks and insurers: 22%
- foreign institutional investors: 38%

⁹ There is no clear description of the relationship between the institutional investor and ultimate beneficiary. As a rule, insurers provide the ultimate beneficiaries with guarantees that certain results will be achieved. Unlike, for example, a mutual fund, an insurer does not invest for the risk and account of the ultimate beneficiary. How an insurer accounts to the ultimate beneficiary therefore differs in an essential way from how a mutual fund accounts to the ultimate beneficiary.

Voting policy

32% of the institutional investors published information about their voting policy on their website. In relative terms, companies in the pension fund/investment fund category publish this information most frequently (45%). Banks/insurers (22%) and foreign institutional investors (15%) lag behind.

Exercise of the voting rights

The provisions of the code on the annual and quarterly obligation to report on how the voting right is exercised are complied with by almost 30% of the institutional investors. Here too the pension funds/investment funds (33%) lead the way. The banks/insurers (22%) and foreign institutional investors (15%) once again lag behind.

Reporting on the implementation of voting policy

Best practice provision IV.4.3 is complied with by 26% of the institutional investors. The pension funds/investment funds score 37%, the banks/insurers 11% and the foreign institutional investors 15%.

2.7. Points for attention

The average attendance rates at general meetings were low (like last year). The consequence of low attendance rates of this kind is that the shareholders who do attend can put a disproportionately heavy stamp on the course of the meeting. The Committee expresses the hope that the use of electronic aids can contribute to higher attendance rates in the future. The legislation to promote the use of electronic means of communication at general meetings, which will come into force on 1 January 2007, offers companies a legal basis for using these means of communication.

The Committee is critical about the place generally accorded to the treatment of corporate governance on the agenda of the general meeting. The Committee believes that it follows from the code that items concerning the annual report and corporate governance should be raised before the agenda item concerning the discharge of the management board from liability for its conduct of the company's affairs.

The changes that have occurred in relation to the issue of depositary receipts for shares and anti-takeover measures are viewed positively. Most trust offices grant voting proxies to depositary receipt holders without any limitations. This does justice to best practice provision IV.2.8. The Committee also welcomes the fact that depositary receipt holders increasingly issue binding voting instructions to the trust office.

The figures for compliance with the code by institutional investors are low (as they were last year). The Committee regrets this, all the more so because the effectiveness of the code relies – to a significant extent - on a proactive attitude on the part of shareholders.

3. International developments

Below is an overview¹⁰ of the developments in the field of corporate governance since November 2005.¹¹

European Union

On 10 January 2006, the European Commission published a proposal for a directive on shareholder rights designed to facilitate the exercise of cross-border voting rights by introducing minimum standards, for example with regard to the period of notice for general meetings, the right to add items to the agenda and the right to ask questions. The European Corporate Governance Forum made a recommendation on 24 July 2006 that securities intermediaries should be obliged to facilitate the exercise of voting rights by their clients. Negotiations on this proposal are currently taking place in the Council and the European Parliament.

On 6 March 2006, the European Corporate Governance Forum issued a statement clarifying the 'comply or explain' principle. To ensure that the principle is effective, there must be a real obligation to comply or explain. There should also be a high degree of transparency while shareholders should be able to hold company boards accountable for this.

On 15 April 2006, the European Commission invited tenders for a study on 'Proportionality between ownership and control in EU listed companies'. It was announced on 26 September 2006 that the study would be carried out by Institutional Shareholder Services, Sherman & Sterling and the European Corporate Governance Institute.

On 17 May 2006, the Council and the European Parliament adopted Directive 2006/43/EC on statutory audits (amending the Eighth Council Directive on company law). The purpose of the Directive is to strengthen and harmonise statutory audits. It introduces, among other things, an obligation for listed companies to establish an audit committee.

On 14 June 2006, the Council and the European Parliament adopted Directive 2006/46/EC (amending the Fourth and Seventh Directives on annual accounts). The Directive introduces an obligation to disclose information about transactions with related parties and off-balance sheet arrangements. It also introduces an obligation to disclose a corporate governance statement as a specific section of the annual report.

On 24 July 2006, the European Corporate Governance Forum issued a statement on internal risk control. The Forum does not at present see any need to introduce a legal obligation at EU level for company boards to certify the effectiveness of internal controls.

¹⁰ The overview contains a summary of developments. A comprehensive overview is available via the website of the relevant organisations.

¹¹ The overview is partly based on a survey conducted by the University of Tilburg.

United Kingdom

On 13 October 2005, the Financial Reporting Council published a Revised Turnbull Guidance on internal risk control. This has applied to listed companies since 1 January 2006. The changes in relation to the 2003 Turnbull Guidance are limited.

- A new preface has been added in order to encourage boards to study the application of the guidance constantly, and to review whether they can make more of the opportunity provided by the internal control statement to communicate with shareholders about internal risk management and control.
- The introduction has been reorganised to enhance the message that the guidance is intended to reflect sound business practice, and to help companies to implement the requirements of the Combined Code relating to internal control.
- The responsibility of directors is clarified in the sense that directors are expected to exercise the same standard of care when viewing the effectiveness of internal control as is applicable to them in the exercise of their general duties.
- The guidance on internal audit has been moved to the Smith guidance on audit committees.
- Boards should confirm in the annual report that the necessary actions have been or are being taken to remedy any significant failings or weaknesses identified in the course of the internal risk control process, and should include in the annual report the information they consider necessary in order to assist shareholders' understanding of the main features of the company's risk management process and system of internal control.

A small number of changes were made to the Combined Code on Corporate Governance on 27 June 2006. The main changes are as follows:

- The limitation that the company chairman may not sit on the remuneration committee has been changed in that he may now do so if he is considered independent on appointment. It is nevertheless recommended that he should not chair the committee.
- A 'vote withheld' option has been added to proxy appointment forms to enable shareholders to indicate if they have reservations on a resolution, but do not wish to vote against it.
- It is recommended that companies publish, on their website, the details of proxies lodged at a general meeting where votes are taken on a show of hands.

The Companies Act 2006 was passed on 8 November 2006. The legislation is the result of eight years' preparation for a complete overhaul of the Companies Act 1985. The aim of the Act is to simplify company law for private companies. The main changes are:

- The responsibility and liability of directors is laid down in the Act. It is provided, among other things, that directors must act in the interests of the shareholders, while simultaneously taking account of the long-term consequences of a decision and the interests of the company's employees, suppliers, customers and the environment.

- There is an obligation for listed companies to devote attention to the future in their reports, including future risks and opportunities.
- It will be easier for indirect investors to exercise their rights. Shareholders can also limit the liability of the company's external accountant to what is fair and reasonable.
- A new sanction is introduced for providing untrue or misleading information in the audit report.
- An obligation is introduced for institutional investors to disclose voting information.
- Private companies no longer need to have a company secretary or to hold an annual general meeting. The model articles of association have also been modified.

The Act will come into effect in stages in the period from January 2007 to October 2008, and will apply to the United Kingdom as a whole.

Germany

On 1 November 2005, the Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) and the Kapitalanleger-Musterverfahrensgesetz (KapMuG) came into force. The KapMuG introduces the possibility of instituting a class action. The main provisions of the UMAG are as follows:

- it is easier for the company to bring a claim for damages against the management and supervisory boards before the courts;
- better protection is now afforded against misuse of the shareholders' ability to bring an action to have a resolution set aside;
- a 21-day registration date has been introduced to make it easier for shareholders to exercise their voting rights.

Changes were made to the German Corporate Governance Kodex on 12 June 2006. The main changes are:

- the remuneration of individual directors should be disclosed;
- the length of a normal general meeting of shareholders should be limited to 4-6 hours.

Under § 161 Aktiengesetz, the management board and the supervisory board of listed companies are required to state annually that the Kodex is applied. Alternatively, they must explain which recommendations have not been applied, and why.

Italy

In Italy, the new Codice di Autodisciplina di Società Quotate was published in March 2006. This code contains many changes to its predecessor, the most important of which are as follows:

- A so-called lead independent director is introduced if the chairman and the managing director are one and the same.
- Content takes precedence over form in the assessment of the independence of directors. Examples are given of the criteria of independence. The *collegio sindacale* is involved in the

correct application of the criteria and provision is made for separate meetings of independent consultants.

- The definition of the structure and terms of the remuneration has been modified by means of a distinction between executive and non-executive directors. The duties of the remuneration committee have also been specified.
- The internal control arrangement has been adjusted to take account of the evolution of international best practice. The roles and relationships between those concerned (in particular the *collegio sindacale* and the internal control committee) have been clarified.
- The arrangement concerning conflicts of interest has been modified.
- Transparency should be provided regarding the choice of a unitary or two-tier board model and the reasons for this.

Italian companies are not legally obliged to comply with the code. Compliance with the code is monitored by Borsa Italiana.

Spain

The new Código Unificado de Buen Gobierno was published in Spain in May 2006. The main elements are:

- Binding criteria for independent directors.
- Articles of association of the company should contain limitations on voting rights or other anti-takeover defences.
- The number of executive directors should be kept to a minimum.
- A third of the directors should be independent.
- Introduction of the lead independent director.
- Recommendation on gender diversity.
- The remuneration report should be submitted to the AGM for an advisory vote.
- The remuneration of individual directors should be disclosed in the remuneration report.
- Introduction of a whistleblower's scheme.

The 'comply or explain' principle applies to the Código (Article 116 of the Ley del Mercado de Valores).

The United States

On 14 September 2006, the SEC's arrangement granting certain foreign companies a postponement for the filing of a statement concerning internal risk control was extended to the fiscal year ending on or after 15 July 2007.

On 7 November 2006, new SEC rules came into force concerning the transparency of the remuneration of executives and directors, transactions with related parties, the independence of directors and directors' ownership of shares. The aim of the changes is to make proxy and information statements, reports and registration statements more user-friendly, and to ensure that shareholders are better informed about the remuneration of directors.

On 12 September 2006, the Committee on Markets Regulation, an independent and impartial group of leading members of the investor community, business, finance, law, accounting and academia announced a study to determine how to maximise the competitiveness of the US capital markets. The Secretary of the Treasury, Henry Paulson, has endorsed the value of the study. The Committee published its interim report on 30 November 2006. The report recommends changes in capital markets regulation based on the twin goals of enhancing shareholders rights while reducing excessive and overly burdensome regulation and litigation. Some key recommendations are:

- companies that use classified boards (staggered appointments of board members) should be required to obtain shareholder authorisation to adopt a poison pill; if this is not done within three months, the pill should automatically lapse.
- the appointment of new directors should preferably be made on the basis of an absolute majority rather than a plurality of the votes;
- the SEC should clarify whether shareholders are entitled to ballot access;
- shareholders should be given the choice of deciding how disputes with their companies should be resolved – through arbitration or non-jury trials;
- the SEC should move to a more risk-based regulatory process, emphasising the costs and benefits of new rules; in addition, regulations should rely on principles-based rules and guidance, insofar as possible;
- the SEC should adopt a more reasonable materiality standard both for internal controls and financial statements;
- the SEC and the PCAOB should adopt enhanced guidance on auditors' roles and duties in testing for compliance with Section 404;
- if a revised Section 404 is too burdensome for small companies (\$75 million market cap and less), the SEC should recommend to Congress that they be exempted from auditor attestation and be subject to a more reasonable standard for management certification.

Other developments

The Committee has concluded that no other significant changes have occurred in the field of corporate governance in the EU and the US since November 2005.

Chapter 2 – Assessment and analysis

1. Internal risk management and control systems

1.1 Application of best practice provisions II.1.3 and II.1.4:

Best practice provision II.1.3:

The Committee notes that compliance with most parts of best practice provision II.1.3 is good, with the exception of the part requiring a code of conduct to be placed on the company's website. Local companies in particular do not comply with this part. As no explanation is often given for the non-application of this part, the Committee assumes that there are no objective reasons for non-compliance.

A code of conduct records what values and standards are important in the business, and thus indicates what 'soft controls' are present. The Committee considers that, from this point of view, it is important for each company to have and publish a code of conduct, regardless of its size.

Best practice provision II.1.4:

The Committee notes that only about 70% of the companies apply important parts of the code dealing with financial reporting. This particularly applies to the statement that the risk management and control systems provide a reasonable assurance that the financial statements do not contain errors of material significance, and the statement that the risk management and control systems have operated properly in the year under review. Approximately 60-70% of the companies that do not apply these parts of the provision are local.

The Committee also notes that only about 80% of the companies give a description of the operational and strategic risks. Once again, approximately 70% of the companies that do not apply this part of the best practice provision are local.

Only about 60% of the companies give a description of the risks of legislation and regulation. Non-application of the relevant provision of the code also occurs frequently in the case of the larger companies.

The statement that there are no indications that the risk management and control systems will not work properly in the current year is the least applied part of the provision. It is applied by only about 55% of the companies. Approximately 65% of the companies that do not apply this part of the provision are local.

The Committee notes that, with the exception of the description of the risks of legislation and regulation, local companies fail to apply II.1.4 most frequently. It should be noted, however, that the local companies are also the largest category of company. Within the local company category, the rate of application per part varies from around a third (the statement about expected functioning) to around two thirds (description of the operational and financial risks). It follows that a considerable number of local companies are able to apply the best practice provisions. The Committee therefore considers that there is no need for a generic exception for local companies regarding applicability.

It is apparent from the survey that the application of provision II.1.4 has greatly improved. The Committee takes into account that in the past year not all companies have yet been able to organise their systems on the basis of the good practice recommendations contained in the Committee's first report of December 2005. The extent to which companies have incorporated the Committee's 2005 recommendations will only become fully apparent in the report on the 2007 financial year. Accordingly, the Committee does not regard it as desirable to produce further guidelines this year. The Committee confirms, for the record, that it expects companies to take its 2005 recommendations to heart in their reports on 2006.

The Committee also notes that not many companies yet quantify identified risk factors when these occur. The Committee urges companies to give this matter their attention. If the risks are quantified, their consequences for investors become clearer. Furthermore, quantification can help the management of the company to establish the right priorities in relation to possible risk management measures.

1.2 Framework for internal risk management

Calls are being heard for more guidance on measures that a management board should introduce in order to obtain sufficient substantiation for the statements prescribed in provision II.1.4.

Representatives of small companies, both in the Netherlands and elsewhere, have indicated that the COSO framework for internal control imposes an unduly onerous administrative burden.

It is also evident from consultations and publications that there is still confusion about the relationship between the provision in the Dutch corporate governance code and comparable provisions abroad. Reference is made, above all, to the United Kingdom (Combined Code) and the United States (SOX). By adopting a principle-based approach, the code and the guidance given by the Monitoring Committee tend towards the line taken by the Combined Code in the UK. A discussion is currently being conducted in the United States about the stringent (possibly excessively stringent) elaboration of the SOX legislation in additional rules. In addition, more guidance is being produced for companies. The SEC also believes that this should be more principle-based, and that account should be taken of the special needs of smaller companies.

The Committee believes that the present system, as contained in the code and in the first Monitoring Report, should be and remain principle-based. A generally accepted practice can be established in the market by the various parties concerned, in consultation among themselves. The Committee does not consider it expedient at present to introduce further national rules. Nor does it consider that a more stringent interpretation of the principles in detailed implementation rules would be desirable. The present principle-based system is also in keeping with the recommendations of the Code Committee in the UK, as contained in the Revised Turnbull Guidance. The Committee closely monitors international developments in this field and urges those concerned to do the same (see paragraph 1.3 for further information).

SOX applies to Dutch companies that also have a listing in the United States. Where the SOX provision on internal control and reporting in relation thereto is applied in full, the Committee considers that this meets the Dutch requirements in respect of the internal control objective and financial reporting.

1.3 Disclosure of the report of the external auditor to the supervisory board

Article 2:393, paragraph 4 of the Netherlands Civil Code, obliges the external auditor to report to the supervisory board and the management board on the audit of the annual accounts. This requirement is amplified by best practice provision V.4.3 of the Code.

Institutional investors have advocated that the report of the external auditor to the supervisory board on his audit of the annual accounts (the so-called management letter) should be disclosed. They argue that this would allow a more informed discussion in the general meeting of shareholders.

Auditors have pointed out, however, that disclosure of the management letter might change its function: instead of bringing matters to the attention of the management board and the supervisory board, the letter would come to serve as a form of verification, in keeping with the statutory function of the auditor. Reference has also been made to the importance of the relationship of trust between the external auditor and the supervisory board and management board.

The Committee would observe that in the present set-up, the role of the external auditor in this respect is to identify deficiencies and not to check or verify the internal risk management and control system: if the report of the external auditor to the supervisory board mentions serious deficiencies, the external auditor should check that they are also described in the annual report. If this is not the case, the auditor has a duty to draw attention to these deficiencies in his report. The management board and supervisory board are responsible for the annual report; through his report and his duty to identify deficiencies, the external auditor has an indirect responsibility for it.

The Committee considers that if the report of the external auditor were to be disclosed, this would alter the nature of the relationship between the management board and the external auditor. Disclosure of a report on the quality of internal control would only be possible if there is a generally accepted framework for internal control. The standard for approval would then inevitably shift in the direction of SOX 404. The Committee regards this as undesirable. The Committee is therefore not in favour of disclosure of the external auditor's report to the supervisory board and the management board. This does not alter the fact that the external auditor does have an identifying role.

2. Remuneration policy

2.1 Introduction

The pay of directors of large companies attracts much public attention. The public debate about how remuneration is determined, the relationship between performance and remuneration and, above all, the level of remuneration tends to flare up year after year.

Apart from general public attention, directors' pay also deserves the special attention of the Committee. As further research has shown (see chapter 1 of this report), compliance with the provisions of the code relating to remuneration policy is relatively poor. The same is true of the recommendations that the Committee made in this respect last year.

It should be noted, for the record, that the Committee reports in accordance with the scope of the code. Like last year, the Committee does not make any pronouncements about:

- the level of remuneration;
- the remuneration policy in non-listed companies; and
- the public and semi-public sector.

The analysis below is based on the survey carried out by the University of Groningen on behalf of the Committee. The design of this survey has already been explained in chapter 1, section 1.2. Section 2.2 will examine factors that play a role in determining the remuneration policy. Section 2.3 concludes with a number of points for attention.

2.2 Remuneration policy

Transparency about remuneration policy

Research and consultation show that more must be done to comply with the provisions of the code on board remuneration. In the opinion of the Committee, the application of provisions II.2.9 and II.2.10 of the code concerning the remuneration report of the supervisory board (about the remuneration of management board members) leaves something to be desired. These provisions read as follows:

- II.2.9 The remuneration report of the supervisory board shall contain an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years.*
- II.2.10 The overview referred to in II.2.9 shall, in any event, contain the following information:*
- a) a statement of the relative importance of the variable and non-variable remuneration components and an explanation of this ratio;*
 - b) an explanation of any absolute change in the non-variable remuneration component;*
 - c) if applicable, the composition of the group of companies (peer group) whose remuneration policy determines in part the level and composition of the remuneration of the management board members;*
 - d) a summary and explanation of the company's policy with regard to the term of the contracts with management board members, the applicable periods of notice and redundancy schemes and an explanation of the extent to which best practice provision II.2.7 is endorsed;*
 - e) a description of the performance criteria on which any right of the management board members to options, shares or other variable remuneration components is dependent;*
 - f) an explanation of the chosen performance criteria;*
 - g) a summary of the methods that will be applied in order to determine whether the performance criteria have been fulfilled and an explanation of the choice of these methods;*
 - h) if performance criteria are based on a comparison with external factors, a summary should be given of the factors that will be used to make the comparison; if one of the factors relates to the performance of one or more companies (peer group) or of an index, it should be stated which companies or which index has been chosen as the yardstick for comparison;*
 - i) a description and explanation of each proposed change to the conditions on which a management board member can acquire rights to options, shares or other variable remuneration components;*
 - j) if any right of a management board member to options, shares or other variable remuneration components is not performance-related, an explanation of why this is the case;*
 - k) current pension schemes and the related financing costs;*
 - l) agreed arrangements for the early retirement of management board members.*

The AEX, AMX and AMS companies often explain their remuneration policy in their annual report. However, the explanation requested by the code is often not given (in full). Transparency in relation to the performance criteria for the variable part of the remuneration is also rather meagre. The AEX

companies, which generally give an explanation of the performance criteria applied by them (part (f) of II.2.10), are an exception to this. It is mainly local companies that do not apply this provision.

In practice, it has also proved difficult to use the information given in the annual report to make an accurate reconstruction of the remuneration awarded to board members.

Process and structure of remuneration policy

The code shows that there must be a clear relationship between the performance of the company and the variable remuneration of management board members. This makes demands on the *process* by which the variable remuneration is determined, and on the *structure* of the remuneration contract.

Process

The most important features of the process by which variable remuneration is established are:

- a) information about the structure (transparency of the structure) of the remuneration contract;
- b) independence from the management board of both the remuneration committee and any remuneration expert consulted by the committee; and
- c) shareholders have a say in the remuneration policy in combination with retrospective accountability to the shareholders about the manner in which remuneration policy is implemented in practice.

The supervisory board is responsible for the remuneration policy. The remuneration committee plays a key role in determining the process by which variable remuneration is established. Provision III.5.11 stipulates that the chairmanship of the remuneration committee should not be held by the chairman of the supervisory board. In the opinion of the Committee, it is desirable that the chairman of the supervisory board should be closely involved in the work of the remuneration committee. Drawing up and implementing the remuneration policy is, after all, a key task of the supervisory board. It is therefore advisable for the chairman of the supervisory board to be a member of the remuneration committee.

Structure

The *structure* of the remuneration policy has three important elements (see best practice provision II.2.10 for the further details).

- a) what is the maximum and/or average variable remuneration as a percentage of the fixed salary;
- b) what part of the variable remuneration is dependent on measurable and predetermined performance criteria, which of these criteria are disclosed publicly and which part of the variable remuneration is determined on the basis of subjective criteria and/or on a discretionary basis; and
- c) what part of the variable remuneration is dependent on this year's performance, what part is dependent on the long-term performance, and to what extent is the variable remuneration granted conditionally.

Complex composition of remuneration contract

Information about the structure of the remuneration contract is in many cases insufficient and incomplete. This is partly due to the complexity of the remuneration contracts. The larger listed companies (AEX companies) in particular use relatively complex remuneration contracts. One of the reasons for this is because executive pay for this category of company is internationally oriented. The use of complex remuneration contracts is the rule rather than the exception internationally. This complexity is also attributable to the intricacies of remuneration contracts.

To ensure that remuneration policy is manageable, the supervisory board is responsible for promoting the simplicity, clarity and transparency of remuneration contracts. Supervisory directors should therefore be sufficiently capable of resisting international usage while providing a counterweight for the opinions of consultants who encourage the complexity of remuneration contracts.

The need for such a counterweight is underlined by the fact that complex remuneration contracts make it more difficult to communicate clearly with outsiders about the composition of such contracts. They also make it more difficult for the supervisory board to implement the remuneration policy, and hamper the board in accounting for this policy to the shareholders.

The code contains explicit provisions about the aim of remuneration policy and the responsibilities of the general meeting and the supervisory board in this connection. In the principle to chapter II.2 (remuneration), the code states the following regarding the level and composition of remuneration:

'The amount and structure of the remuneration which the management board members receive from the company for their work shall be such that qualified and expert managers can be recruited and retained. If the remuneration consists of a fixed and a variable part, the variable part shall be linked to previously-determined, measurable and influenceable targets, which must be achieved partly in the short term and partly in the long term. The variable part of the remuneration is designed to strengthen the board members' commitment to the company and its objectives.'

'The remuneration structure, including severance pay, is such that it promotes the interests of the company in the medium and long term, does not encourage management board members to act in their own interests and neglect the interests of the company and does not 'reward' failing board members upon termination of their employment. The level and structure of remuneration shall be determined in the light of, among other things, the results, the share price performance and other developments relevant to the company.'

It can be inferred from the above that, as far as executive pay is concerned, the code makes a distinction between the level of remuneration on the one hand and the relationship between remuneration and performance on the other. It is therefore necessary (in the light of the reporting by the supervisory board) that the following should be made transparent:

- the level of remuneration;
- the remuneration components;
- why a given amount of remuneration has been decided upon (the relationship between reward and performance).

2.3 Findings

The Committee is concerned about the lack of transparency about executive remuneration, and about remuneration policy and its implementation.

The remuneration policy and its impact must be presented to the general meeting of shareholders in transparent and understandable terms. This responsibility falls to the supervisory board; in practice, this requires the supervisory board to monitor the complexity of remuneration contracts.

The Committee recommends that the remuneration policy be covered in a separate section of the annual accounts, in a manner that is both transparent and uniform.

The argument that the complexity of the remuneration contract makes it impossible to provide clarity does not convince the Committee. A possible solution for making complex remuneration contracts more manageable (internally) may be the introduction of a pay ceiling for each board member. Such a ceiling would determine the total maximum value of the remuneration of a board member who scores 100% in respect of all performance criteria; for this purpose, the value of share-related remuneration elements (whether conditional or otherwise) would be determined at the moment they are granted. This ceiling operates only internally and can contribute to the better manageability of remuneration for the supervisory board. External disclosure of the remuneration ceiling is not recommended (among other things because this could drive up pay).

The Committee also believes that the supervisory board should explicitly report on the effectiveness of the company's remuneration policy. In particular, the relationship between remuneration and performance should be made clear not only before¹² but also after the event. Performance should be interpreted in this connection as the contribution to long-term value creation by the company.

Clear information about the remuneration structure would be an important means of establishing a direct relationship between performance and the (variable) remuneration of management board members. To what extent the remuneration structure also results in an actual link between remuneration and performance can be determined only by gathering empirical data over a number of years (about the extent of the correlation between executive pay and corporate performance). An empirical survey of this kind has now been instituted by the Committee among Dutch listed companies. The Committee will comment on the results of this survey in 2007.

¹² For further details, please refer to the first report issued by the Monitoring Committee (page 53 and onwards).

Chapter 3 – Conclusions

Conclusions

Compliance with the code by companies

The rate of compliance with the code is higher than last year. On average, 96% of the provisions of the code are complied with by the companies.¹³

Despite the high rate of compliance with the code, the Committee points out that compliance should be 100%. This does not mean that all provisions of the code should be applied unconditionally.

Departures from the code are possible provided that they are explained.

Local companies lag behind the AEX, AMX and AMS companies in terms of compliance with the code.

The Committee considers that the size of these companies should not be an excuse for less strict observance of the code. The provision of an explanation in the event of a departure from the code (irrespective of the size of the company) is always possible.

The survey was conducted to ascertain how explanations may be classified. As the survey inevitably involves an element of subjectivity, the Committee believes that the results should be viewed with caution. 85% of the explanations given for departures from the code can be classified as *understandable*. Whether the explanation given is verifiable (by reference to information in the public domain) is assessed as positive or neutral in 47% of the cases. The assessment is negative in 12% of the cases. In the remaining cases, it is not possible to give a clear view on whether the explanation is verifiable. The Committee calls on companies to give explicit consideration in the next financial year to ensuring that any explanation given is understandable and verifiable. An explanation qualifies as sound if it is understandable and verifiable. None of this detracts from the general principle that it is for the shareholders to express an opinion on a departure from the code.

The Committee observes that its job is to give an overall picture of compliance with the code by listed companies. The figures on which this is based are generic. The Committee does not make any pronouncements about the manner in which individual companies comply with the code. The Financial Markets Authority (AFM) will supervise annual reporting by companies from 1 January 2007. It is exclusively up to the shareholders to accept the explanation for departures from the code.

The code and shareholders (and general meetings)

The average attendance rate at general meetings is 56% (44% if certified companies that have issued depositary receipts for shares are disregarded). This is once again on the low side (like last year). As a result, shareholders who do attend can exert disproportionately heavy influence over the course of the meeting.

The Committee has considered the place generally accorded to the treatment of corporate governance on the agenda of the general meeting. The Committee considers that it follows from the code that, in

¹³ It should be noted that the foreign companies have not been included in the calculation this year.

so far as corporate governance items are on the agenda, they should be placed before the item dealing with the discharge of the management board from liability for its policy.

The changes that have occurred in relation to the issue of depositary receipts for shares and anti-takeover measures are viewed positively. The Committee welcomes the fact that most trust offices grant voting proxies to depositary receipt holders without any limitations.

On average, 30% of institutional investors comply with the code (a low figure, like last year). The Committee regrets this, all the more so because the effectiveness of the code relies – to a significant extent - on a proactive attitude on the part of shareholders.

Practicability of the code

The rate of application of the code provisions is 92%. It can be inferred from this that the code is eminently practicable. The Committee's survey shows that the application of the code is below average in two areas, despite clear improvements since last year. These are the provisions of the code dealing with:

- remuneration policy; and
- the statement on risk management and control systems.

The Committee has studied these two issues in more detail.

Remuneration policy

The Committee is concerned about the lack of transparency about directors' pay and (the implementation of) the remuneration policy. The remuneration policy and its impact must be presented to the general meeting of shareholders in transparent and understandable terms. This responsibility falls to the supervisory board; in practice, this requires the supervisory board to monitor the complexity of remuneration contracts. The Committee recommends that the remuneration policy be covered in a separate section of the annual accounts, in a manner that is both transparent and uniform.

The Committee also believes that the supervisory board should explicitly report on the effectiveness of the company's remuneration policy. In particular, the relationship between remuneration and performance should be made clear, not only before but also after the event. Performance should be interpreted in this connection as the contribution to long-term value creation by the enterprise.

Internal risk management and control systems

The application of best practice provision II.1.4 (concerning the management board statement about the functioning of the internal risk management and control system) has been greatly improved since last year. Within this context, the Committee takes into account that, in the past year, not all companies have yet been able to organise their systems on the basis of the good practice recommendations in the Committee's first report of December 2005. The extent to which companies

have incorporated the Committee's 2005 recommendations will become fully apparent only in the report on the 2007 financial year. Accordingly, the Committee does not regard it as desirable to produce further guidelines this year. The Committee confirms, for the record, that it expects companies to take its 2005 recommendations to heart in their reports on 2006.

The Committee believes that the present system, as contained in the code and in the first Monitoring Report, should be and remain principle-based. A generally accepted practice can be established in the market by the various parties concerned, in consultation among themselves. The Committee does not consider it expedient at present to introduce further national rules. Nor does it consider that a more stringent interpretation of the principles in detailed implementation rules would be desirable.

The Committee would observe that, in the present set-up, the role of the external auditor in this respect is to identify deficiencies and not to check or verify the internal risk management and control systems: if the report of the external auditor to the supervisory board mentions serious deficiencies, he should check that they are also described in the annual report. If this is not the case, the auditor has a duty to draw attention to these deficiencies in his report. The management board and supervisory board are responsible for the annual report; through his report and his duty to identify deficiencies, the external auditor has an indirect responsibility for it. The Committee is therefore not in favour of disclosure of the external auditor's report to the supervisory board and the management board.

Composition of Corporate Governance Code Monitoring Committee

Chairman

Professor Jean Frijns,

Professor of Investments at the Vrije University of Amsterdam

Former asset management director and member of the board of the ABP Pension Fund

Members

Professor Kees Cools RA

Professor of corporate financing and strategy at the University of Groningen

Partner in The Boston Consulting Group

Gert-Jan Kramer

Chairman of the supervisory board of Royal BAM Groep NV

Former president of Fugro NV

Professor René Maatman

Professor of Asset Management, Radboud University Nijmegen

Head of the Legal and Tax Department of ABP Vermogensbeheer

Professor Jaap van Manen RA

Professor of Auditing at the University of Groningen

Partner in PricewaterhouseCoopers Accountants NV

Mrs Kitty Roozmond

Director of the Association of Provincial Authorities

Former vice-chair of the Federation of Netherlands Trade Unions (FNV)

Jos Streppel

Member of the Management Board and Chief Financial Officer, Aegon NV

Member of the Supervisory Board of KPN NV

Member of the Supervisory Board of Van Lanschot NV

Chairman of the Shareholders Communication Channel Foundation

Professor Albert Verdam

Professor of company law at the Vrije University of Amsterdam

Legal adviser to Royal Philips Electronics NV

Secretariat:

Wicief Poesiat

Financial Markets Directorate, Ministry of Finance

Martha Meinema

Enterprise Directorate, Ministry of Economic Affairs