New Dutch Corporate Governance Code - the Changes in detail

The Monitoring Committee Corporate Governance Code has published the new Corporate Governance Code. The Code applies to any financial year starting on or after 1 January 2017. This Legal Alert outlines the principal changes to the 2008 Code and the consultation documents for the new Code. Please also see our Legal alert of 8 December 2016 covering the highlights of the new Code.

Our Corporate Governance Toolbox will be published in due course. The Toolbox will include guidance on the implementation of, and compliance with, the Code. It will also include new rules and regulations for the boards of Dutch listed companies and other practical tools for compliance with the Code. An update of our handbook "Corporate Governance in Nederland" is expected to be published in spring 2017.

Principal changes to the 2008 Code
The principal changes to the 2008 Code revolve around seven themes:

1. A greater focus on long-term value creation
2. Reinforcement of risk management
3. A shift of focus in effective management and supervision
4. Introduction of culture as an explicit part of corporate governance
5. Improvement and simplification of the remuneration provisions in the code
6. Shareholders and the general meeting
7. Quality requirements for "comply or explain" statements
A greater focus on long-term value creation
The Code emphasises long-term value creation. One of the new principles provides that the management board focuses on long-term value creation and designs and, accordingly, implements a strategy aimed at effecting this. The management board must timely involve the supervisory board in designing a strategy. The Code lists a number of aspects to be taken into account when formulating a strategy, including relevant aspects related to running a business, and the interests of stakeholders. The supervisory board supervises strategy implementation for long-term value creation. In the management report, the management board must substantively describe its vision for long-term value creation, its strategy in achieving this, and contributions made in the previous financial year. The supervisory board must render account, in the supervisory board report, about how it was involved in designing the strategy and supervising implementation of the strategy.

Reinforcement of risk management
The risk management provisions have been extended.

- The various stages of risk management (risk assessment, implementation and monitoring) have been further developed in best practice provisions.
- The internal audit function, performing under the management board's responsibility, has been strengthened and includes direct access to all information relevant for the performance of the internal audit functions duties. The explanatory notes to the Code explicitly state that if a company does not have an internal audit function because of its size, for example, outsourcing may be an adequate alternative.
- The appointment and dismissal of the senior internal auditor by the management board is subject to supervisory board approval. The audit committee must advise on the appointment and dismissal of the senior internal auditor.
- The internal audit function must draw up a work plan, and involve the management board, the audit committee and the external auditor. The work plan is subject to management board and supervisory board approval, respectively.
- The scope of the statement in the management report on how the internal risk management and control systems function has been expanded. It is no longer limited to financial reporting risks, but pertains to material risks in general. The statement must include the following:
  a. the management report provides sufficient insights into any failings in the effectiveness of the internal risk management and control systems;
  b. the internal risk management and control systems provide reasonable assurance that the financial reporting does not contain any material inaccuracies;
  c. based on the current state of affairs, it is justified that the financial reporting is prepared on a going concern basis; and
  d. the management report states those material risks and uncertainties that are relevant for the expectation on the company's continuity for a period of 12 months after the preparation of the report.
- The requirements for the content of the audit committee's report have been extended. The report must elaborate on:
  a. how the effectiveness of the internal risk management and control systems and the internal and external audit process have been assessed;
  b. substantive considerations in respect of financial reporting; and
  c. how the material risks and uncertainties relevant for the expectation of the company's continuity have been analysed and discussed including the principal findings of the audit committee.
- The supervisory board must provide the external auditor with an overview of his performance report.
- The company must issue a press release on the interim termination of the relationship with the external audit firm, and must state the reasons for termination.
- The role the supervisory board and the audit committee play in the appointment, dismissal and performance review of the external auditor has been clarified. The appointment and dismissal procedure has been brought in line with existing legislation.
The supervisory board must be provided with the principal issues between the external auditor and the management board as regards the draft management letter and the draft audit report.

A shift of focus in effective management and supervision
With a view to recent management and supervision developments, the Code includes a number of amended and expanded best practice provisions.

Executive committee
The Code does not include specific requirements on the structure of executive committees. However, a company with an executive committee should take into account the checks and balances that are part of a two-tier board system. In the management report, the management board must elaborate on why it opted for an executive committee, its role and composition, and how the interaction between the supervisory board and the executive committee has been structured.

Diversity
The diversity provisions have been extended to managing directors. If the company has an executive committee, it should also have a diversity policy for the executive committee. The Code emphasises that diversity must also include age, nationality, expertise, independence and experience. The management board should clarify the diversity policy for managing directors and supervisory directors in the corporate governance statement (comply or explain), addressing what the policy objectives are, how the policy has been implemented and what the outcome has been in the previous financial year.

Independence criteria for supervisory directors
The committee believes that engaged shareholders contribute to long-term value creation. To this end, the independence criteria for supervisory directors have been amended. There is more room for non-independent supervisory directors who hold a 10% or greater stake in the company or represent a company that holds such a stake. Where this previously was limited to only one non-independent director, each major shareholder or group of major shareholders may now have one representative in the supervisory board, provided that the majority of the supervisory directors is independent.

The chairman of the supervisory board must be independent.

Term of appointment
The maximum term of office for supervisory directors has been amended. The maximum term is twelve years, provided that re-appointment after eight years is only possible for a maximum of two two-year terms. Any re-appointment after eight years must be substantiated in the supervisory board report.

The early resignation of a managing or supervisory director should be announced in a press release, stating the reasons for resignation.

Evaluation
The Code includes further provisions on the supervisory board's evaluation of its own performance. The Code now also provides that the management board evaluates at least once a year how it and the individual managing directors have performed. This is in addition to the supervisory board's evaluation of the management board.

Additional positions
Managing and supervisory directors must notify the supervisory board in advance if they intend to accept an additional position. Additional positions must be discussed by the supervisory board at least once a year. All supervisory positions held by managing directors are subject to the supervisory board's approval.

Openness and responsiveness
The managing directors and the supervisory directors should stimulate openness and responsiveness within the management board and the supervisory board, as well as between the different corporate bodies within the company.
Misconduct and irregularities
The best practice provisions regarding reporting of misconduct and irregularities have been extended.

- Pursuant to the explanatory notes to the Code, the scope of the procedure for reporting actual or suspected irregularities within the company is wider than the procedure required under the Whistleblowers Act. The latter procedure is limited to suspected misconduct that jeopardises a social interest whereas the procedure under the Code also deals with the reporting of irregularities.
- The opportunity to file reports under the procedure for reporting actual or suspected irregularities applies to all parts of the company's business, whether in the Netherlands or abroad.
- The management board must inform the chairman of the supervisory board without delay of any signs of actual or suspected material misconduct or irregularities.
- The external auditor must inform the chairman of the supervisory board without delay if, during the performance of his duties, he discovers or suspects an instance of misconduct or irregularity.
- The supervisory board monitors the operation of the procedure for reporting actual or suspected misconduct or irregularities, appropriate and independent investigations and adequate follow-up on recommendations for remedial actions. If the management board itself is involved, the supervisory board will have the option of initiating and coordinating its own investigation.

Conflicts of interest
The best practice provisions on conflicts of interest involving managing directors and supervisory directors have been aligned with the statutory conflicts of interest provisions.

One-tier board
The Code includes a number of amended and expanded best practice provisions for one-tier boards:

- The independence requirements for the supervisory board apply equally to non-executive directors.
- The chairman of the board chairs the meetings of the board and ensures the well-balanced composition of the board and its committees, as well as their proper functioning.
- The chairman of the board must be independent.
- Neither the chairman nor a former executive director may act as chairman of the audit or remuneration committees.
- The non-executive directors must report on their supervision as conducted over the previous financial year in the management report or in a separate report. The reporting requirements are in line with the reporting requirements for supervisory directors in a two-tier board.

In addition, the explanatory notes to the Code state that:

- Provisions of the Code that apply to supervisory directors apply equally to non-executive directors. Where this is not possible, the 'comply or explain' principle will apply.
- Tasks that are specifically assigned to the chairman of the supervisory board lie within the scope of duties of the chairman of the board.

Introduction of culture as explicit part of corporate governance
The Code introduces culture as one of the driving forces behind effective corporate governance.

- The management board should set values that contribute to a culture aimed at the company's long-term value creation. The management board should discuss these values with the supervisory board.
• The management board is responsible for embedding and maintaining the company's values. In doing so, it looks to the strategy and the business model, the commercial environment and the existing culture within the company. Based on this, the management board decides whether adjusting the company culture is necessary.
• The management board and supervisory board should also discuss the company's behaviour and culture in consultation with the works council.
• The management board should strive to stimulate behaviour that adheres to the company's values, and it should promote these values by displaying exemplary behaviour.
• The management board should describe the values in the management report in detail, and should explain how these are embedded in the code of conduct, and whether they are effective and comply with the code of conduct.

**Improvement and simplification of the remuneration provisions in the code**

*Executive remuneration*

The principles and best practice provisions on executive remuneration have been simplified.

• The remuneration policy should be simple and transparent, it should stimulate the company's long-term value creation and take into account the pay ratios within the company and its business.
• The management board should inform the supervisory board of the remuneration of the executive committee members and discuss their remuneration with the supervisory board annually.
• To encourage managing directors to be more involved in setting their own remuneration, the remuneration committee should take into account the views of individual managing directors on the amount and structure of their remuneration. These views do not form part of the account given of the implementation of the remuneration policy.
• In the remuneration report, the supervisory board should outline the ratio between the remuneration of the managing directors and that of a representative reference group within the company and its business.
• The Code clarifies that the severance payment must never exceed one year's salary. Further, the Code states that the severance payment will not be paid in the case of the early termination of an agreement with a managing director at the request of such managing director, or in the case of serious imputable or negligent behaviour.

*Shareholders and the general meeting*

The Code includes a number of new best practice provisions.

• Managing directors and supervisory directors nominated for appointment should attend the general meeting where their appointment is being considered.
• The management board should use the response time for further deliberation and constructive consultation, with, amongst others, the relevant shareholder(s), and should explore alternatives. At the end of the response time, the management board should report on this consultation and on any alternatives, to the general meeting.
• The terms of appointment for trust office (administratiekantoor) board members have been amended in accordance with the terms of appointment for supervisory board members.

*Quality requirements for 'comply or explain' statements*

The Code provides more guidance on the use of the 'comply or explain' principle. In connection with an earlier recommendation of the European Commission, the Code provides a framework for companies on how to explain a deviation from the Code.

*Entry into force of the Code. Transitional provisions*

The Code is expected to, in due course, be designated by governmental decree as a code of conduct. The Code includes a number of specific transitional provisions. These provisions
have been included, with regard to the committee believing that companies should be allowed time to implement a number of new principles and best practice provisions.

- The Code does not apply to the 2016 management report; management reports for financial years that started before 1 January 2017 must be drafted in accordance with the 2008 Code. The committee recommends that the key aspects of a company's corporate governance structure and compliance with the Code be discussed at the 2018 general meeting.
- Where the Code includes additional arrangements, regulations, procedures or otherwise written records, or amendments, a company is deemed to have applied the Code if these are in place by 31 December 2017, at the latest.
- The terms of appointment for supervisory directors in effect on the date of entry into force of the Code and which exceed eight years, will be respected, as long as they comply with the 2008 Code.
- Supervisory directors who are up for reappointment in 2017 may be reappointed for a third four-year term as long as the maximum twelve-year term, as outlined in the 2008 Code, is not exceeded.

Principal changes to the consultation document
The Code includes a number of changes to the consultation documents for a revised Code.

- Best practice provisions that have been deleted:
  a. The obligation to appoint at least one supervisory director with specific expertise in existing and future technological innovation and business models.
  b. The prohibition for the supervisory board chairman to act as chairman of the selection and appointment committee.
  c. The obligation to set up a special takeover committee.
  d. The provision allowing payment to supervisory directors in shares. In line with the 2008 Code, the Code explicitly states that supervisory directors must not be paid in shares.
  e. The provision that the remuneration policy must specify the parameters for claw-back of variable remuneration.
  f. The obligation to provide information to the general meeting in English.
  g. The obligation for companies with a one-tier board to appoint a CEO.
- Best practice provisions that have been added:
  a. The Supervisory board must inform the external auditor on the outline of his performance report.
  b. In the case of an executive committee, the company must have a diversity policy for executive committee members. The supervisory board rules should include a paragraph dealing with its relationship with the executive committee.
  c. A number of the remuneration provisions have been reintroduced in line with the 2008 Code. In addition, among other things, the Code provides that in the remuneration report, the supervisory board must outline the ratio between the remuneration of the managing directors and that of a representative reference group within the company and its business.
  d. A number of transitional provisions on the entry into force of the Code and the maximum term of appointment for supervisory directors.
- Best practice provisions that have been clarified or amended:
  a. The Code explicitly states that principles may also be deviated from.
  b. The Code no longer refers to long-term value creation for all stakeholders. Reference is made to long-term value creation for the company and its business. When formulating a strategy aimed at this, the interests of all stakeholders must be taken into account.
  c. The explanatory notes to the Code explicitly state that if a company does not have an internal audit function, for instance because of its size, outsourcing may be an adequate alternative.
  d. The in-control statement no longer needs to include a confirmation that the company's continuity is expected to be safeguarded for the next twelve months.
e. The provisions for the 180-day response time if a shareholder requests that an item be put on the agenda for a general meeting that could result in a change in the company’s strategy, have been aligned with the 2008 Code.

f. The provisions on the issue of depositary receipts for shares have been aligned with the 2008 Code. The Code provides that depositary receipts for shares can be a means of preventing a (chance) majority of shareholders from controlling the decision-making process as a result of absenteeism at a general meeting. Depositary receipts for shares may not be used as a defensive measure.

g. The maximum term of office for supervisory directors has been clarified. The maximum term is twelve years, provided that re-appointment after eight years is only possible for a maximum of two two-year terms. Any re-appointment after eight years must be substantiated in the supervisory board report.

h. For individual shareholders or groups of shareholders holding ten percent or more of the shares in the company, a maximum of one representative may be appointed in the supervisory board.

i. The role of the supervisory board with regards to the draft management letter and draft audit report has been clarified.

j. The provisions on company culture have been clarified.

k. The role of the supervisory board on the remuneration of executive committee members has been mitigated.

Contact

If you have questions or require further information regarding this Legal alert please contact:

Harm-Jan de Kluiver / T +31 20 577 1458 / E harm-jan.dekluiver@debrauw.com
Lodewijk Hijmans van den Bergh / T +31 20 577 1088 / E lodewijk.hijmansvandenbergh@debrauw.com
Reinier Kleipool / T +31 20 577 1777 / E reinier.kleipool@debrauw.com
Marielle Legein / T +31 20 577 1629 / E marielle.legein@debrauw.com
Martin van Olffen / T +31 20 577 1500 / E martin.vanolffen@debrauw.com
Bernard Roelvink / T +31 20 577 1905 / E bernard.roelvink@debrauw.com
Jean Schoonbrood / T +31 20 577 1837 / E jean.schoonbrood@debrauw.com
Michael Schouten / T +31 20 577 1958 / E michael.schouten@debrauw.com