Capital Markets - Portugal

Recent developments in corporate governance

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Introduction

The case for good corporate governance practices in listed companies has been in the limelight in Portugal since the late 1990s, mainly due to the efforts and initiatives of the public sector and the Securities Market Commission (CMVM). As a result, despite the adoption of a classic 'comply or explain' approach, laws and regulations have had a strong and direct effect on sensitive governance matters, restraining the ability of listed companies to opt for alternative arrangements. For instance, both the Companies Code and specific decree-laws directly provide for:

- a majority of independent members in audit committees and other supervisory bodies;
- disclosure of directors' remuneration; and
- shareholder approval of a mandatory statement regarding directors' remuneration.

This approach departed from the recommendatory approach initially taken by the European Commission,(1) although it is partially in line with recent documents by the commission.(2) Since 1999, the 'comply or explain' approach has been based on a corporate governance code approved and adopted by the CMVM (which has become increasingly detailed over time), rather than on the standards and principles set by issuers and investor communities. However, this approach is quickly evolving towards the active involvement of such communities, with the support of the CMVM.

With the release of Regulation 1/2010, the CMVM has paved the way for companies to opt for an alternative governance code to its official code, provided that such an alternative framework meets high standards of transparency and investor protection. In 2011 the very active and vocal Portuguese Issuers Association began running a self-assessment of alternative corporate governance practices to the regular assessment performed by the CMVM. In addition, the Portuguese Institute of Corporate Governance (IPCG) recently put forward the first code of corporate governance originated by the private sector. This warrants a comparative analysis of the methodology of the IPCG code with that of the CMVM.

Scope of corporate governance and bylaws

The first new relevant feature of the IPCG code is its compatibility with the existing bylaws of listed companies, which means that a company need not amend its bylaws to comply. As some of the relevant matters affecting the corporate governance profile of a listed company are enshrined in the bylaws (eg, supermajorities, voting caps, voting enhancement mechanisms, takeover defences and dual classes of shares), the IPCG code consequently covers none of these topics.

This approach takes a slightly different direction from that of the CMVM, which explicitly discourages companies from introducing disproportions between shareholders' economic and political rights and anti-takeover defences in their bylaws that are not regularly submitted to shareholders for confirmation. The IPCG code clearly retreats from these fields and focuses corporate governance more on the relations between shareholders and other corporate bodies and on how checks and balances are adopted by listed companies, which is the approach to corporate governance commonly taken in countries such as the United Kingdom and Germany. In this respect, the scope of corporate governance recommendations is consequently reduced.

One size does not fit all

The IPCG code also takes a flexible approach to corporate governance, as the content of some recommendations may vary according to the size of the company. This is particularly true with respect to:

- the number of non-executive members, independent members and committees of the board;
- the structure of internal audit and internal risk management systems; and
- the existence of a nomination committee.

However, this is not yet the case for formulating specific recommendations for small and medium caps, as exists in France. Nonetheless, this flexible approach allows companies to adapt governance structures to their size while still complying with the code. Had this possibility not been granted, companies would have had to rely on their size as a reason to explain why they did not follow the recommendation. Even where a company provides a reasonable explanation, it would not be considered compliant with the recommendations in third-party assessments of corporate governance practices.

The CMVM code also makes some room for adaptation to size, but flexibility is not its primary feature. It is assumed that small and medium-sized companies would have to play on the 'explain' field with regard to some key recommendations (eg, the number of independents on the board and audit and risk management structures) if those recommendations prove unsuitable to their size.

Self-tailored governance rules

On this race to flexibility, plenty of recommendations in the IPCG code rely on companies' internal regulations to craft a better governance system moulded to each company. However, the system outlined in the code does not constitute a blank cheque for companies, as it clearly sets forth the approach to be taken with those regulations. It could even be argued that there is no actual deference to companies' internal regulations, as the code clearly imposes the adoption of specific rules (eg, the need for board authorisation for members that wish to be additionally appointed to the executive committee of other companies or for an annual assessment of the performance of executive directors). Nevertheless, the company plays an important role in adapting the governance framework to its own specific needs.

Competition between governance codes

The IPCG code has triggered a degree of competition between corporate governance rules and recommendations. The cores of the IPCG and CMVM codes are very similar and both are reliable and demanding. However, the features of the IPCG code might be more appealing to small and medium-sized companies and to companies whose bylaws, for historical reasons, rely on clauses to preserve a balance between different shareholders, while the CMVM code might be more comfortably followed by companies that abide by other stringent and demanding governance rules, such as financial institutions. The fact that the CMVM has opted to relieve its own code of several burdensome provisions, thereby allowing for a lighter approach, should not be ignored. Nonetheless, the debate between the two sets of rules will definitely improve corporate governance.

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Endnotes

(1) Recommendation 2009/385/EC, April 30 2009; Recommendation 2005/162/EC, February 15 2005.

(2) For example, the "Action Plan: European company law and corporate governance – a legal modern framework for more engaged shareholders and sustainable companies", December 12 2012.

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