SCORECARDS: THE REGULATOR’S PERSPECTIVE

This note reflects on current practice in the European Union. All EU countries have corporate governance codes that operate on the “comply or explain” basis as well as requirements set out in law. Regulators have responsibility for ensuring the law is followed, but their responsibilities in relation to “comply or explain” codes tend to be more limited. It is these responsibilities that are addressed in this note.

Responsibilities usually involve monitoring overall compliance levels with the code in order to judge its effectiveness and ensuring that companies have disclosed the information expected of them, as judgements on whether a company has applied the code appropriately are considered to be a matter for the shareholders. In some EU countries these monitoring and enforcement activities are carried out by stock exchanges or other organisations rather than regulators.

Scorecards based on the national code are quite commonly used by regulators as a means of measuring levels of compliance with that code. Regulators will scrutinise the annual reports of some or all listed companies, depending on the size of the market, and then aggregate that information to provide an overview of compliance levels. This helps them to judge the code’s impact and informs decisions on whether it should be revised.

In some countries this information is published in aggregated form in an annual monitoring report. Examples include France, Italy and Sweden. In addition, in some countries, for example Spain, regulators will take enforcement action if they feel that the information provided in the report is insufficient for shareholders to understand how the code has been applied.

It is rare for regulators to publish data on code compliance by individual companies. As far as I am aware the only EU country in which this is done is Portugal, where the securities regulator includes in its annual monitoring report its assessment of each company’s overall compliance with the code (in percentage terms) in each of the last two years.

One can see how this information can be useful to investors. However, I think one of the main reasons other regulators have not followed this example is that, as “comply or explain” recognises that adopting alternative governance arrangements to those set out in the code can in some circumstances be the better course of action, measuring percentage compliance with the code is not a very precise measure of a company’s governance as so much depends on behavioural aspects of governance that cannot easily be assessed by reading annual reports. Except in the financial sector, most regulators do not have the legal powers or resources that would enable them to make a more rounded assessment of the effectiveness of the governance of individual companies.
However there are other approaches regulators can consider. In Austria companies are expected to obtain an independent assessment of their compliance with the code at least every three years. This assessment is carried out against a scorecard issued by the body responsible for the code, and the results are published on the company’s website.

While this sort of independent and standardised assessment provides some assurance to investors, and a high degree of comparability between the practices of different companies, it is still arguably an assessment of compliance with the code rather than of the “real” governance of the company. As long as its limitations are understood by those who use the information – which includes the media as well as investors - this may not matter. But concerns about this sort of information being misunderstood or misused is another reason why regulators are reluctant to publish assessments of individual companies.

Chris Hodge
UK Financial Reporting Council