



Resolution 1392 (2004)¹

Corporate ethics in Europe

Parliamentary Assembly

1. Given their potentially damaging economic impact, the recent series of corporate scandals in the United States of America and Europe call for a reaction from both governments and regulatory bodies. These scandals reflect a climate of poor corporate ethics which risks undermining trust in the economic system as a whole. Without accurate and reliable financial statements, corporate management, investors, shareholders and business partners cannot have true confidence in each other. The key reaction to this crisis must be to restore transparency in the European and global corporate world.

2. As well as a failure of control over financial accounting, these scandals reflect a more serious breakdown in the corporate culture. Conflicts of interest arising from the 'principal-agent' split between the owners of companies (shareholders) and their management will always exist. However, these conflicts become impossible to reconcile when rewards available to corporate executives rise to excessively high levels, which are perceived by the general public as unacceptable, and prove even more dangerous when unrelated to performance and entailing no downside risk. A more rigorous system of checks and balances needs to be introduced.

3. To remedy such a breakdown in corporate ethics will require not only legislative change but also a broader cultural response. Some of the recent legislative reforms in the United States, particularly regarding accounting firms, could be used as a starting framework and should be complemented by a European approach based more on principles than law, using supervision and a set of guidelines.

4. The Assembly recommends:

4.1. that the European accounting industry be reorganised, along the lines of recent United States legislative reforms, including the requirement that firms provide fully independent auditing services, separate from any other non-audit business. Greater competition within the industry should also be encouraged to prevent the potentially harmful concentration of power within a few dominant firms. The creation of a European supervision body is also recommended;

4.2. the harmonisation of accounting rules, thus preventing international 'loopholes' which may encourage poor corporate governance. In order to reconcile the different 'legal'- versus 'principles'-based approaches to accounting in the United States and Europe, respectively, a 'comply or explain'-based method could be adopted where strict guidelines are in place with a clear explanation being required by companies if they choose to deviate from them;

4.3. that the Council of Europe's previous work in the field of market manipulation – such as the 1989 Convention on Insider Trading (ETS No. 130) – be built upon and implemented more strictly in order to prevent further market abuses. Common regulation in this field should be introduced across Europe, combined with stricter regulation and sanctions for insider trading offences;

4.4. the tightening and supervision of so-called 'Chinese Wall' requirements for investment banks, separating advice given to corporate management and shareholders, to avoid future conflicts of interest within the financial community;

1. Text adopted by the Standing Committee, acting on behalf of the Assembly, on 7 September 2004 (see [Doc. 10103](#), report of the Committee on Economic Affairs and Development, rapporteur: Mr Brunhart).



4.5. corporate social responsibility training for corporate executives in order to heighten management awareness of good corporate ethics. Training should also be provided for non-executive directors, shareholders and trustees in order to ensure greater checks on management and the observance of a suitable code of corporate ethics. Greater shareholder activism should also be encouraged through more regular voting at companies? annual general meetings, through the use of proxy voting or possibly through the outsourcing of the supervision of governance to specialist divisions or companies;

4.6. separating the roles of the chairman of the board and chief executive officer for listed companies over a certain size, as the fusion of these roles risks placing excessive power in the hands of one official and serves to confuse the operational function of running the company with that involving the supervision of management. It would be desirable to have a genuinely independent chairman responsible for protecting the interests of the full range of stakeholders in the company;

4.7. increased controls over the remuneration of executives, since the rise in recent years of executive pay to levels incomprehensible to the general public may have contributed considerably to the observed deterioration in corporate ethics. Control could be imposed by shareholder-voting on the remuneration of members of the board and by restrictions on non-cash components of remuneration. Full transparency in all aspects of remuneration is more important than levels of pay.