

## **SPEARHEADS LETTER 2009**

To the Management Board and Supervisory Board

**Subject:** Spearheads 2009  
**Ref:** 2008.96  
**Schiphol,** 24 October, 2008

Dear members of the management board and supervisory board,

Eumedion, the corporate governance platform for institutional investors, annually sends what is known as its spearheads letter to the 75 largest Dutch listed companies for the next season of annual reports and shareholders' meetings. The spearheads letter contains important issues that the members affiliated to Eumedion would like to draw your attention to and which they may address in their contributions at the various shareholders' meetings. In the interest of improving the streamlining of the dialogue during the shareholders' meeting, we would greatly appreciate any comments you may have on these points.

Just as it did for the 2008 season, Eumedion has formulated one spearhead and one point for attention for the 2009 season. The spearhead for 2009 is the same as it was for 2008, i.e. the combination of strategy and risk management. The spearhead has been slightly rewritten in response to the experiences in the 2008 season, in an attempt to align with the December 2007 recommendations of the Frijns Committee on the subject of risk management and with the proposals for the updating of the Dutch corporate governance code in this respect. The point for attention is related to corporate pay out policy, i.e. the distribution of cash dividends and the repurchase of own shares, done within the framework of the continuity of the company. The spearhead and the point for attention will be explained below.

## **1. Spearhead – strategy and risk management**

In 2008 the combination of strategy and risk management was the spearhead. Eumedion and the Royal NIVRA carried out a joint study of the compliance with this spearhead shortly after the end of the AGM season. The resulting report 'Inzicht in onzekerheid'<sup>1</sup> shows that a large number of listed companies are still failing to describe and quantify the company-specific risks. Investors and other interested parties, however, want at least to have insight into the most important risks facing a company. The present turbulence on the financial markets and the uncertainty this creates with regard to investment decisions and valuation issues make it clear once more that insight into risks is crucial where the investor is concerned. Strategy and risk management will once more be Eumedion's spearhead in 2009 as a consequence.

Shareholders will be particularly interested in the following elements:

- i) a reliable description of the strategy for the medium term and long term;
- ii) a description of the main risks relating to company strategy, which also addresses the company's attitude to these risks ('risk appetite');
- iii) a description of the main strategic, operational, financial, legislative, regulatory and financial reporting risks for the company, with at least a description of the qualitative impact of these risks. Institutional investors require a summary of perhaps the five most important risks, instead of a summing up of all conceivable risks;
- iv) a sensitivity analysis of the risks identified, if it is reasonable to expect such an analysis in view of the best practices in the sector in question;
- v) a description of the design and operation of the internal risk management and control systems with reference to the main risks as these could materialize in the course of the financial year;
- vi) a description of any important shortcomings discovered in the internal risk management and control systems during the financial year, what significant changes may have been implemented in the systems, what possibly important improvements to the systems have been planned, and the discussion of all of this with the audit committee and the supervisory board.

Eumedion would like to see the inclusion of an informative, transparent and broad risk paragraph in the financial statements for 2008, containing at least a summary of and a reference to the information to be published on the subject of risks and risk management, provided in a concentrated form at that point in the financial statements.

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<sup>1</sup> G.M.H. Mertens and I.H.C. Blij, *Inzicht in Onzekerheid; Onderzoek naar de risicoparagrafen in de jaarverslagen 2007 van beursfondsen*, (Insight into Uncertainty, a study of the risk paragraphs in the 2007 financial statements of listed companies), commissioned by the Royal NIVRA and Eumedion, June 2008.

## **2. Point for attention: dividend policy and repurchase of own shares**

Eumedion has two reasons for designating corporate pay out policy, i.e. the distribution of cash dividends and the repurchase of own shares, done within the framework of the continuity of the company, as a point for attention. First of all, Eumedion had a study carried out in 2008 into the reporting on and accountability for the policy of the Dutch listed companies with regard to dividend distribution and the repurchase of own shares. One of the conclusions of this investigation is that the provision of information relating to dividend distribution and the repurchase of own shares is meagre and leaves room for improvement. Secondly, a bill came into effect on 11 June 2008 that extends the possibilities of repurchasing own shares. In 2008 some companies already anticipated the coming into force of this bill by including a reference to the wider scope of the new legal provisions in their articles of association, and Eumedion expects that more proposals for amendments to the articles of association will be put forward during the AGMs in 2009. In July 2008 Eumedion drafted a number of recommendations in response to the study referred to above and the new legal provisions regarding the repurchase of own shares. The institutional investors who are members of Eumedion will use these recommendations in their assessment of the items on the agenda relating to the information provided on the policy on dividends and reserves, and any proposal for amendment of the articles of association on the point of the repurchasing scope in relation to the proposal to authorize the management board to acquire own shares. The recommendations are in the appendix to this letter.

We are available should you require further clarification of this letter.

Yours sincerely,

Rients Abma  
Executive Director

## **Appendix: Eumedion recommendations of 23 July 2008 on the authorization to repurchase own shares and on accountability for the dividend policy**

### **1. Reason**

The bill on the implementation of the amended Second EU Company Law Directive came into effect on 11 June 2008. The new legal provisions make it possible, in principle, for listed companies to repurchase their own shares up to the limit of 50 percent of the issued capital. Until 11 June 2008 the stipulation applied that the general meeting could authorize the management board to repurchase own shares up to the limit of 10 percent of the issued capital. The validity period of the authorization granted by the general meeting remains 18 months, as a consequence of an amendment passed by the lower house of the Dutch parliament. The new legal provisions also permit companies to grant loans to third parties to enable them to repurchase shares in the company, subject to certain conditions. The shareholders' meeting must approve a loan of this kind by a majority of 95% of the votes, which means in practice that it is practically impossible for listed companies to grant loans to third parties.

A number of companies (including Philips, Van der Moolen and Arcadis) amended their articles of association during the 2008 AGM season to conform with the bill, and more companies will probably follow suit in the 2009 AGM season. It is important for institutional investors to prepare a number of recommendations on how to deal with the new powers in advance of the 2009 AGM season. The point of departure for these recommendations does not have to be the new legal provisions alone and other aspects of the repurchase of own shares can also be examined. Although the authorization to repurchase own shares is an item on the agenda of practically every annual shareholders' meeting, this is no reason why it should be treated as a matter of routine. The repurchase of own shares is worthy of attention, both from the point of view of capital maintenance and in relation to the duty of care that a company has towards its shareholders (equal treatment where possible). Furthermore, the possibility of using the repurchase of own shares as an anti-takeover measure must be prevented.

Paragraph 2 proposes a number of recommendations that institutional investors can use as tools when assessing the item on the agenda relating to the authorization of the management board to repurchase own shares. In view of the fact that granting loans is an illusion where listed companies are concerned, no recommendations have been formulated in this respect. It should be noted that it is already laid down by law that companies cannot vote shares repurchased and that shareholders must receive equal treatment.

The University of Groningen carried out research commissioned by Eumedion into the policy of Dutch listed companies with regard to dividend distribution and the repurchase of own shares, and one of the conclusions of this study is that the information provided on the dividend policy and the repurchase of own shares is rather meagre and capable of improvement. In addition, the relevant information is given at different places in the financial statements. Paragraph 3 makes a number of recommendations for more transparency.

The Eumedion recommendations on the repurchase of own shares and the dividend policy are an addition to the Eumedion Corporate Governance Manual published in May 2008.

## **2. Recommendations on delegation of the power to repurchase own shares**

The following recommendations are proposed, which follow more or less naturally from the recommendations on the authorization to issue new shares published by Eumedion at the start of 2008.

(a) **Organs involved in delegation.** In the event of the delegation of the power to repurchase own shares, the management board is designated by the general meeting for this purpose. If shares are actually repurchased on the basis of the granted authorization to repurchase, the repurchase requires the prior approval of the supervisory board. In the case of a one tier board structure, the actual repurchase requires the approval of the non-executive board members.

(b) **Placement on the agenda and explanatory notes.** A clear explanatory note must be provided on the item on the agenda concerning delegation of the repurchasing powers. This note must set out the reasons for the proposal and the conditions for the exercise of the powers to be delegated (including the maximum number of shares to be repurchased, the delegation period and the method of establishing the repurchase price). In the event of delegation of the powers to repurchase different kinds of shares, these proposals must be included as separate items on the agenda with separate explanatory notes.

(c) **Maximum number of shares to be purchased.** The company is permitted to *acquire* shares to an amount of no more than half of the issued capital during the delegation period. If no material reorganization of the capital structure is foreseen in the delegation period envisaged, however, the company is entitled, in principle, to *hold* no more than 10 percent of the issued capital in own shares at any time during this delegation period. This means that the maximum number of own shares that a company has “on the shelf” at any moment must not, in principle, exceed 10% of the issued capital. If a material reorganization of the capital structure is foreseen during the delegation period envisaged, the number of own shares that may be held at any time during the delegation period may be raised to

20 percent of the issued capital<sup>2</sup>. The company must, however, provide a clear explanation for authorization of this kind. If the company wishes to repurchase more of its own shares within the authorization period, the own shares previously repurchased must first be withdrawn, which requires a resolution by the general meeting. It is advisable, therefore, certainly in the event of a material reorganization of the capital structure, that the request for authorization to repurchase own shares should be accompanied by a request for authorization to withdraw the shares repurchased.

(d) **Re-issue of repurchased shares.** When authorization for the repurchase of own shares is requested, it must always be clearly stated whether it is intended to re-issue these shares (in connection with stock option and/or share plans for example). In the absence of an explanation of this kind, it must be assumed that the shares repurchased will not be re-issued. Repurchased shares may not be issued to a party with the objective of facilitating a takeover, or of preventing a takeover by another party ('targeted stock placement').

(e) **Delegation period.** Delegation of the power to repurchase own shares can be granted for a maximum period of 18 months as from the moment of the resolution to delegate. The resolution to delegate must state that the general meeting is entitled to withdraw the delegation and the conditions for withdrawal must be set out in detail in the resolution to delegate. It is preferable in the event that a delegation period is still current, to formulate the proposal as an extension to this current delegation, in order to prevent uncertainty as to whether the current delegation will continue to exist alongside the new delegation.

(f) **Method of repurchase.** When authorization for the repurchase of own shares is requested, it must be clearly stated how the shares in question will be repurchased; on the stock exchange or by a different method. It must always be clear that all shareholders in equal measure can offer their shares to be repurchased. In unusual cases in which shares from one or a number of shareholders are repurchased, clear reasons must be provided for these transactions and these must be clearly apparent to all shareholders.

(g) **Permitted repurchase price.** The repurchase price must not, in principle, be higher than the market price of the share. The market price is the price quoted for the share on the stock exchange on the day of the repurchase, or the average share price over a certain period, which must not be longer than 5 days. If the management board requests authorization for a higher repurchase price, a clear explanation must be provided for this.

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<sup>2</sup> Other maximums may apply in the event of a proposal to purchase financing preference shares and/or protective preference shares.

(h) **Rate of repurchase.** Repurchase transactions are not intended to influence the price of the share temporarily and the company must provide clear information, therefore, on what precautions have been taken to prevent repurchase transactions from influencing the price on the stock exchange each day. The maximum number of shares to be repurchased per day of trading must always be stated (or what maximum percentage of the shares traded each day), how repurchase transactions are connected with the share-price related objectives in the remuneration policy and which internal or external party has been charged with the repurchase.

(i) **Transparency on repurchase transactions.** The company will include a summary of transactions in the financial statements showing developments in the number of own shares repurchased, in order to provide clear insight into the development of the repurchasing transactions during the financial year.

### **3. Recommendations dividend policy**

- (a) **Reporting.** The dividend policy must be clearly and transparently described at a place in the annual report. Transparency would benefit if the relationship between the dividend policy and other possible relevant aspects of the strategic policy of the company could be clarified; these aspects could relate to long-term development, innovation, mergers and takeovers, and executive remuneration. A company that is paying dividend states which criterion or criteria is/are applied in determining the rate of the dividend and provides sound substantiation for this. A company that is not paying dividend (as yet) reports in the annual report why it is not doing so (as yet) and when and under what conditions the management board will actually consider paying dividend. A company that is considering paying dividend states when it is possible that dividend may be distributed.
- (b) **Placement on the agenda.** A company's dividend policy is dealt with and accounted for as a separate item on the agenda for the general meeting.