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**NOTE**

From:	Presidency
To:	The Working Party on Social Questions
No. prev. doc.:	14223/14 SOC 685 EGC 38 ECOFIN 911 DRS 125 CODEC 2006
No. Cion doc.:	16433/12 SOC 943 ECOFIN 708 DRS 130 CODEC 2724
Subject:	Proposal for a Directive of the European Parliament and the Council on improving the gender balance among directors of companies listed on stock exchanges and related measures

Delegations will find attached an explanatory note concerning Article 4b.

**Explanatory note on the use of the flexibility clause  
in Article 4b**

The Directive sets a quantitative objective for the representation of members of the under-represented sex on company boards: either 40% for non-executive directors or 33% for all directors. However, this objective is not a rigid quota: MS are not obliged to attain it and there are no sanctions determined at EU-level for failing to do so. Essentially, what the Directive seeks is progress. Rather than specifying a particular result, it obliges MS to establish a process that is conducive to the improvement of the gender balance, with the overall objective in mind.

The Directive provides two options for implementation:

**Option 1 - Default option of transposing the procedural requirements in Article 4a**

Through their transposing legislation, MS should ensure the following: listed companies where members of the under-represented sex hold less than 40 % of the non-executive director positions or less than 33 % of all director positions (and those companies *only*) are required to comply with the procedural requirements of the Directive concerning selection of candidates. No company will be penalised for failing to attain the quantitative objective if it has put in place the transparent and objective selection procedure in compliance with the transposing legislation. On that condition, in relation to the attainment of the objectives the Directive essentially establishes a "comply or explain" mechanism, whereby companies that do not attain the objective have to set out the reasons and what they plan to do about it.

It is for each MS to determine how it wishes to provide in its national legislation that the selection for election or appointment to the posts of non-executive directors is to be carried out on the basis of a comparative assessment. Suitability, competence and professional performance should remain the key factors for the selection process.

The deadline for transposition is 2 years after adoption of the Directive.

## MS reporting obligation:

to COM (by 2017 and every two years thereafter): information about measures taken, statistics on the representation of women and men on boards and information received from companies, including (if applicable) information about individual commitments that companies have taken with regard to executive directors.

### **Option 2 – "Flexibility clause" pursuant to Article 4b**

Where a MS prefers not to transpose the Directive's procedural requirements, it can decide to continue applying its national system. provided that it can be demonstrated that the national system is equally effective. Examples of equally effective measures are provided in Article 4b (1a).

#### **1) Initial suspension until 2020**

a) On the basis of the examples in Article 4b (1a)

A MS can take advantage of the "flexibility clause" if it meets the conditions set out in one of the three examples in Article 4b (1a), all of which are deemed by law to guarantee equal effectiveness, before the deadline for the transposition of the Directive. This gives legal certainty to MS wishing to avail themselves of the flexibility clause.

(1) Where national legislation imposes a binding quota of 30 % for non-executive directors or 25 % for all director posts and effective, proportionate and dissuasive enforcement measures apply in the case of non-compliance.

The rationale behind this example is that a binding quota can be understood as ensuring compliance and thus the attainment of the target if sanctions provide a sufficient incentive for compliance.

(2) Where members of the under-represented sex hold at least 30 % of the total number of all non-executive director positions or at least 25 % of the total number of all director positions

This option recognises evidence of results that MS have already reached in terms of gender balance. This option can be taken by MS that have managed to attain a high level of gender-balanced representation irrespective of the means (legislative or not) that have been used.

(3) Where members of the under-represented sex hold at least 25 % of the total number of all non-executive director positions or 20 % of the total number of all director positions at the deadline for the Directive's implementation and the level of representation has increased by at least 7.5 percentage points in the last 5 years. (The five-year period precedes the suspension decision, which should normally coincide with the deadline for the transposition of the Directive.)

This option recognises evidence of progress which is a de facto achievement by MS. However, a lower minimum level of gender balance is compensated by the additional requirement to show significant progress during the 5 years preceding suspension. This option could be used by MS where, due to national circumstances, the starting position is very low, but there is good progress towards gender balance during the 5 years preceding suspension. Progress at least equivalent to the EU average over the last few years (of roughly 1.5 percentage points per annum) is considered evidence of a sufficiently positive trend in the direction of the quantitative objective of the Directive and thus evidence of equal effectiveness.

b) On the basis of other circumstances

The open list of examples currently set out in Article 4b leaves open the possibility that other scenarios could also qualify as equally effective and thus enable suspension of the Directive's procedural requirements. Such a scenario could possibly be a lower level of attainment combined with particularly strong progress over the past years. It is worth mentioning that the greater level of flexibility as a result of an open list of examples exists only at the stage of the initial decision on a suspension. The possibility of extending the suspension beyond 2020 is tied to a closed list of conditions (see below). This ensures the legal certainty regarding the application of the flexibility clause during the whole period of validity of the Directive until its expiry on 31 December 2028.

MS Reporting obligations:

to COM (by 2017 and every two years thereafter):—information about national measures taken, representation on boards – this information should be presented in a manner showing whether and how the conditions for suspension are fulfilled. If applicable, MS should also provide information about individual commitments that companies have taken with regard to executive directors.

## **2) Extension of the suspension beyond 2020 pursuant to Article 4b (2)**

Only those MS that invoke the flexibility clause before 2020 may extend the suspension beyond 2020. In addition, one of two conditions should be met. In this case, for the purposes of legal certainty, the room for interpretation of "equal effectiveness" is limited. There is a closed list of conditions that allows the continuation of the suspension. Continued suspension is only possible where:

(1) the national legislation concerning a rigid quota of 30 % for non-executive directors or 25 % for all posts remains applicable and effective, proportionate and dissuasive enforcement measures apply in the case of non-compliance with these binding targets; or

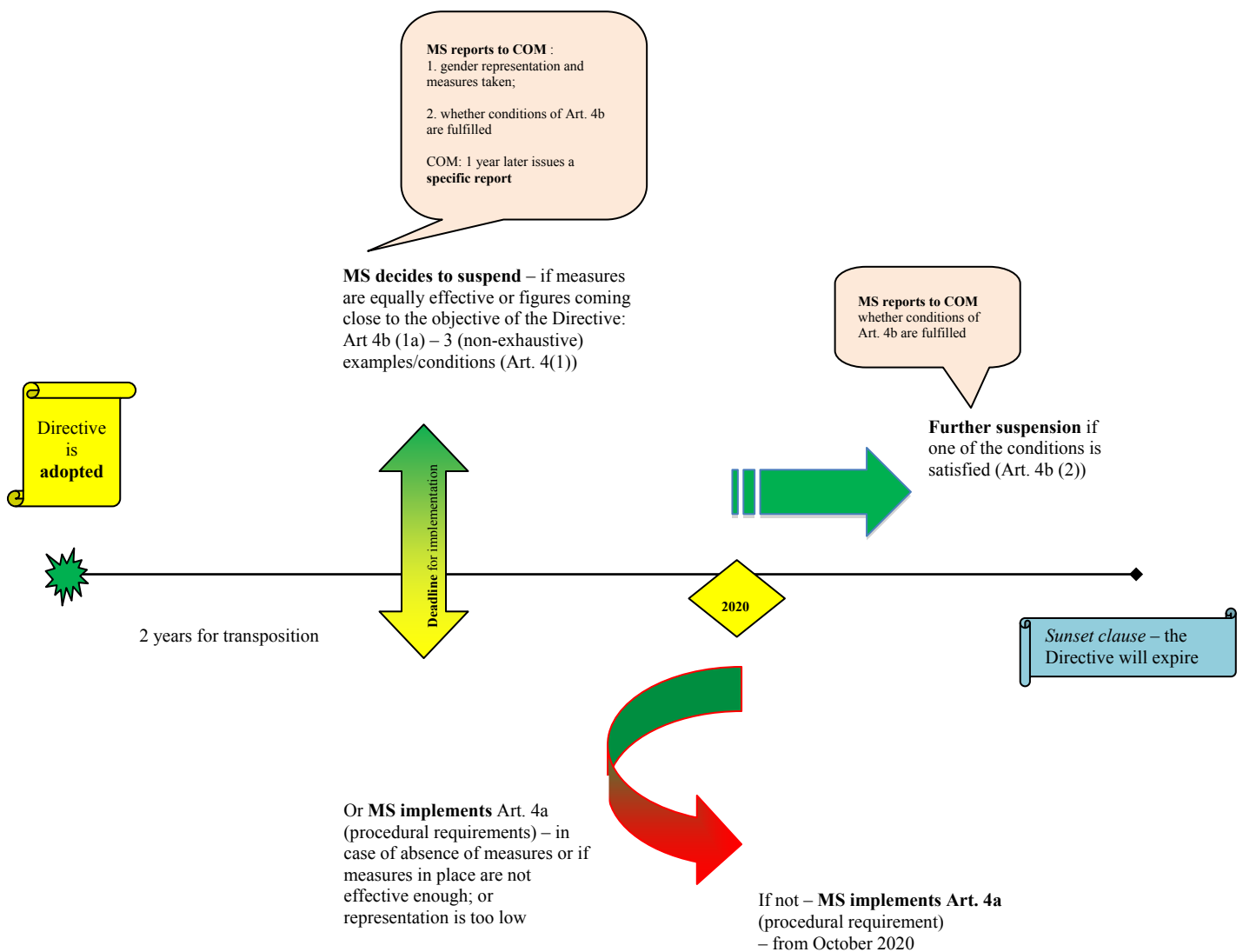
(2) members of the under-represented sex hold at least 30 % of the total number of all non-executive director positions or 25 % of the total number of all director positions by 1 January 2020. This shows clear evidence of the effectiveness of the national measures towards the main quantitative objective of the Directive.

Those MS where such conditions are not met by 1 January 2020 will have a sufficient period of time (until 1 October 2020) for the transposition of the default provisions of the directive (procedural obligations) into their national legislation and their implementation at company level.

Reporting obligation: no change in MS reporting obligation compared to the period before 2020

### **What happens in cases where the statistics fall below the suspension threshold after 2020**

If, after 2020, it turns out from the reporting that the degree of gender balance has dropped below the threshold required for the flexibility clause (Art. 4b(2)(b): 30% for executive posts or 25% for all posts) the MS concerned would have to start implementing Option 1 - the default option of the Directive - as soon as possible.



## The relationship between the conditions for suspension and the quantified objectives of the Directive

It is clear that the quantitative objective of the Directive is 40% for non-executive directors or 33% for both types of directors. However, this objective is not a rigid quota: companies are not obliged to attain it and there are no sanctions determined at EU-level for failing to do so. Rather the Directive recognises that reaching that objective is a process that takes time and depends on various factors. Essentially, what the Directive seeks is progress and rather than guaranteeing a specific result it obliges MS to establish a process that favours greater gender balance with the overall objective in mind.

The conditions for suspension should not be construed as attainment of the ultimate objective but as evidence of the effectiveness of the national measures in terms of sufficient progress towards these objectives. In comparison to the conditions for the initial suspension under Art. 4b(1a) (open list), the extension of the suspension beyond 2020 under Art. 4b(2) is tied to stricter conditions (closed list) and a MS satisfying these standards thus proves the continuing positive trend and the effectiveness of the national measures.

In a sense, the Directive considers an actual achievement of 30% by 2020, the condition set in Art. 4b(2)(b), as sufficient evidence of the efforts of listed companies in pursuit of the quantitative objective of the Directive and therefore replaces the procedural obligation with regard to selection procedures. A lower but certain level of achievement is treated as the functional equivalent of a process which aims to achieve a more ambitious objective but does not guarantee a certain outcome.

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