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Dear Sirs

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European Commission Green Paper – The EU corporate governance framework

Grant Thornton International Ltd (“Grant Thornton”) welcomes the opportunity to comment on the European Commission Green Paper – The EU Corporate Governance Framework (the green paper). We believe that the green paper poses excellent questions with respect to improving the corporate governance framework in the EU in light of the G20’s call for actions to be taken to ensure sustainable growth and to build a stronger international financial system.

Overall, we support the Commission’s efforts to improve corporate governance and believe that the Commission would benefit by taking a more holistic view of corporate governance, in particular by broadening the matters considered.

Specifically, we believe that the Commission should:

- address the role of audit committees (or similar bodies) in corporate governance
- promote measures to ensure more effective disclosure in company reports and
- focus on the independence of non-executive directors and members of relevant board sub-committees.

We also believe that any EU wide corporate governance code should be based upon the “comply or explain” framework to reflect the difference in maturity of markets and companies across the EU.

Holistic view of corporate governance

The green paper states that corporate governance is defined as the system by which companies are directed and controlled, and as a set of relationships between a company’s management, its board, its shareholders and other stakeholders.

We agree with these definitions, and suggest that the Commission should take a wider look at the relationships amongst management, the board, various board committees (particularly the audit committee), shareholders, external auditors and other groups. We are of the opinion that the green paper's focus on directors and shareholders is critical, as boards and shareholders are the key parties in the corporate governance relationship.¹ However, the paper would benefit from considering additional relationships and interactions amongst the various parties who have a stake in the governance of companies.

All of these relationships are at the heart of the separation of ownership and control in companies, and we observe that a primary driver of corporate governance stems from that separation of ownership and control in a company.

We suggest that the Commission consider the recommendations in this green paper in conjunction with those set forth in the green paper on corporate governance in financial institutions, as well as the green paper on audit policy. Auditors are a key participant in the financial reporting chain and corporate governance.

Audit committees

Audit committees comprised of independent directors are critical to a company's financial reporting to its shareholders. The audit committee is an essential link in the relationship amongst the full board of directors, company management, the independent auditors and the company's shareholders.

The European Union's statutory audit directive requires public interest entities to have audit committees, which shall (a) monitor the financial reporting process; (b) monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems; (c) monitor the statutory audit of the annual and consolidated accounts; and (d) review and monitor the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity.² As noted by the International Corporate Governance Network (ICGN), the audit committee should seek to assure itself and shareholders of the quality of the audit carried out by the auditors as well as overseeing their independence.³

Consequently, any attempt to create an EU corporate governance framework should consider the role played by audit committees in the governance of companies. We understand that audit committees are not as well established in some countries in Europe, despite the requirements of the statutory audit directive. This disparity presents an opportunity for the Commission to help promote audit committees throughout the European Union.

¹ See UK Financial Reporting Council (FRC), *Guidance on Board Effectiveness* (March 2011).

² Article 41 of Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts (the "Statutory Audit Directive").

³ ICGN, *ICGN Global Corporate Governance Principles: Revised* at p. 20 (2009).

More effective disclosures to shareholders

The green paper quite properly focuses on directors and shareholders, but does not address disclosure, which is how information is passed from the company – including the full board of directors, the audit committee and management – and the independent auditors, to shareholders. Disclosures are highly relevant to good corporate governance. The OECD has noted that a “corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.”⁴

A number of consultations in the past year have focused on disclosures to shareholders and reporting by auditors.⁵ These papers address the relationships and communications between management, the audit committee, the independent auditor and shareholders, which are critical for good corporate governance.

Many of the papers quite properly are concerned with the auditor’s role in disclosures, and we believe that the auditor can do more than just report on the company’s historical financial statements. As we have noted in our responses to the green paper on audit policy and the green paper on corporate governance in financial institutions, auditors should provide better communication to investors. Auditors could give a degree of assurance on risk data and could provide investors with assurance on increased narrative disclosures in audit committee reports and on non financial information. Grant Thornton member firms would be happy to take on new or enhanced assurance duties.

In addition, the role of the board, the audit committee and company management with respect to disclosures cannot be overlooked, and the clarity and robustness of annual reports must be considered an important part of governance.

We recognize that the specifics of these topics are beyond the scope of this green paper, but we recommend that the Commission consider more effective disclosures by the board, the audit committee and management – and the role of auditors in such disclosures – in conjunction with any recommendations arising out of this paper.

Independence of directors and board committee members

Although the green paper addresses diversity with respect to board members, which we support, it does not generally mention the need for independent non-executive directors. We believe that in order for the board to exercise objective judgement, it is necessary to have independence and objectivity with respect to management. This is especially the case with respect to audit committee members.

⁴ OECD, *OECD Principles of Corporate Governance* at 49 (2004).

⁵ See European Commission, *Green Paper on Audit Policy: Lessons from the Crisis* (Oct. 2010); UK Financial Reporting Council (FRC), *Effective Company Stewardship: Enhancing Corporate Reporting and Audit* (Jan. 2011); International Auditing and Assurance Standards Board (IAASB), *Enhancing the Value of Auditor Reporting: Exploring Options for Change* (May 2011); US Public Company Accounting Oversight Board (PCAOB), *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements* (Jun. 2011).

A majority of the board should be independent, and these independent non-executive directors should meet regularly without executive management present.⁶

In its green paper on corporate governance in financial institutions, the Commission has previously noted the importance of independence as a characteristic of directors: “Recruitment policies which precisely identify the skill needs of the board of directors and which aim to guarantee the objectivity and independence of members’ judgment could help increase the board of directors’ ability to effectively monitor management.”

We therefore recommend that proposals on a corporate governance framework arising out of this green paper address the importance of independent and objective directors.

Comply or explain framework

Good corporate governance will help improve the growth and stability of the capital markets, and will provide shareholders with more confidence in the companies in which they invest. Currently, there are different levels of maturity in the corporate governance models throughout Europe, and we commend the work of the Commission and national governments in improving these frameworks in recent years.

Given these differences in maturity, we support the “comply or explain” framework for corporate governance, where a company must comply with all elements of a code of governance or explain where it has not complied with the code and why. This system retains a degree of flexibility that facilitates implementation in different countries and different companies, whereas a mandatory legal framework would force one set of rules on companies in all sectors of all sizes and in all countries. In the United Kingdom, the “comply or explain” principle was retained by the Financial Reporting Council (FRC) after receiving strong support from both companies and shareholders.⁷

If, in the future, it is discovered that a majority of companies neither comply with a recommendation nor provide a satisfactory explanation, and that EU Member States do not sufficiently monitor and enforce compliance, then an alternative solution must be found. It should be noted, however, that trends in the UK in fact show an increasing adherence to the “comply or explain” framework over time.

- In 2010: **51** percent of the FTSE 350 companies claimed full compliance with the UK Corporate Governance Code; **36** percent of the companies did not comply but explained with “more” detail; **12** percent of companies

⁶ Some EU Member States already require this. For example, the Greek Code currently requires non-executive board members to meet periodically without executive members present.

⁷ See Grant Thornton LLP, *Corporate Governance FTSE 350 review 2010 - Evolving with the Code* (Dec. 2010) at page 2, available at http://www.grant-thornton.co.uk/pdf/corporate_governance.pdf (the “Grant Thornton UK 2010 Corporate Governance Review”).

did not comply but explain with “some” detail; and only **1** percent did not comply or explain.⁸

- In 2005, by contrast, these numbers were: **28** percent, **40** percent, **25** percent and **7** percent, respectively.⁹
- Further, 2010 saw significant improvements in the area of “boilerplating”, which is a frequent criticism of the “comply or explain” framework. “Boilerplating” refers to the practice whereby companies offer the same explanation year on year despite operating in a constantly changing environment. In 2009, while **68** percent of the companies choosing to explain rather than fully comply gave helpful explanations, only **14** percent had made any significant change to their previous year’s explanation. In 2010, **73** percent gave informative explanations with **34** percent making significant changes to their previous year’s explanation.¹⁰

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Yours faithfully



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⁸ See Grant Thornton UK 2010 Corporate Governance Review at page 4.

⁹ See Grant Thornton UK 2010 Corporate Governance Review at page 4.

¹⁰ See Grant Thornton UK 2010 Corporate Governance Review at page 9.

Appendix I - responses to questions in the green paper

Note: Unless otherwise stated, our responses to the specific questions in this appendix are based on the assumption that solutions will operate under the “comply or explain” model. That is, when a question asks whether companies should be “required” to take a certain measure, our affirmative response means that companies should be required to comply with that measure or otherwise adequately explain why they have not complied. Conversely, when we assert that a particular provision should be “voluntary,” this means that companies should not be required to either comply or explain.

General questions

Question 1: Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

No. EU corporate governance measures should apply to all listed companies, regardless of size. In a “comply or explain” regime, however, some small and medium-sized listed companies may believe that some governance measures are disproportionate or not relevant, and may therefore present substantive reasons for not complying.

Question 2: Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

There should be a single corporate governance code applicable to all companies, whether unlisted or listed. However, such a code should be voluntary (yet encouraged) for entities that are both unlisted and that are not public interest entities.¹¹ While all companies should have good governance, there is less of a need to require good corporate governance for companies that do not have shares listed on public exchanges and are not public interest entities.

We note that the important distinction amongst companies with respect to corporate governance requirements should be based upon the nature of their external stakeholders, and not merely upon whether a company is listed or unlisted. For example, public interest entities such as financial institutions or large privately-held companies may be unlisted, yet it is important for these entities to have sound corporate governance because of their economic reach and impact on the capital markets. Therefore, we suggest that there be a single

¹¹ There are different definitions of “public interest entity.” Paragraph 13 of Article 2 of the Statutory Audit Directive generally defines “public-interest entities” as certain listed entities as well as specified credit or insurance entities. It also states that Member States “may designate other entities as public interest entities, for instance entities that are of significant public relevance because of the nature of their business, their size or the number of their employees.”

corporate governance code that is required for listed and public interest entities, but voluntary for unlisted and non-public interest entities.

Boards of directors

Question 3: Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

Yes. Within the “comply or explain” framework, we believe that companies should be required to divide the functions and duties of the chairperson of the board and the chief executive officer. If a company does not comply with this requirement, it must explain in detail why not and perhaps state what it is doing in the alternative.¹²

Separating the duties of these two functions would help to ensure that a single individual does not have too much control over the direction of a company. The board of directors (led by the chairperson) is directly responsible to shareholders and must oversee management. It is more difficult for a board to oversee management if its chairperson is also in management.

Question 4: Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

Yes, we believe that it would be helpful to have recruitment policies that address matters such as duties, profile, diversity, skills and experience across the board and board committees.

We believe that recruitment policies should be the responsibility of the nominating committee or equivalent. In certain instances it may be appropriate for the nominating committee to seek input from investors. The nominating committee should conduct a formal and transparent procedure for nominating new directors, and the nominating committee should be comprised of a majority of independent directors. We understand that in some European countries, there are provisions for the establishment of nominating committees,¹³ but that most listed companies do not comply with these provisions. We believe that having an EU-wide requirement for nominating committees – along with proposed duties for those committees – would result in greater numbers of companies complying with national requirements.

¹² For example, in Greece, the board should appoint an independent vice chairman when: (a) the roles of the chair and CEO are combined or (b) if there is an executive chair of the board.

¹³ Again, the Greek Code states that there should be a nominating committee to ensure that there is an effective and transparent procedure for the nomination of board members. It sets forth responsibilities of the nominating committee, and proposes that it should be composed of at least three members with the majority of its members being non-executive directors.

A company should also have other board committees – eg, audit committee, remuneration committee – with different skills. These committees should likewise be at least majority independent.

Question 5: Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Yes, we believe that listed companies should be required to disclose whether they have a diversity policy, as well as its objectives and content, and they should also be required to report regularly on progress. As noted in our response to the green paper on corporate governance in financial institutions, we support diversity on boards because that helps bring different perspectives to discussions, but there should be no mandatory quotas or other requirements.

In order to enhance diversity, companies could be encouraged to implement introductory programmes for new board members, which could include among other things information on work-life balance issues.

As noted in response to question 4, the nominating committee should focus on knowledge and skills of board members. Efficient boards will possess a range of skills and knowledge appropriate to their business and sector.

Question 6: Should listed companies be required to ensure a better gender balance on boards? If so, how?

We believe that listed companies should seek to have a better gender balance on boards, and that companies should be required to disclose how they are seeking to ensure a better gender balance. At this point, we do not believe that there should be strict quotas with respect to the number or percentage of women on boards, but we would support aspirational goals and guidance on this topic. If in the future these aspirational goals are not met, then the requirement to have quotas should be revisited.

Our reasons for supporting a better gender balance are similar to those set forth in our response to question 5 – diversity amongst board members will help bring different perspectives to discussions and hopefully better responses to issues.

Question 7: Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

No. As we stated in our response to the green paper on corporate governance in financial institutions, the company should have responsibility to ensure that a director is able to contribute the appropriate amount of time to fulfill their role. For example, a director that is also an executive at another company will likely have less time to devote to the job than another director who does not serve as an executive or hold full-time employment at another company.

Instead, we believe that companies should be required to disclose what is expected from their directors, and whether the directors have met these expectations. Such disclosure would include not only the number of board or committee meetings that directors are expected to attend, but more importantly it would also specify the time commitment expected. This would have the beneficial effect of putting directors on notice as to the time commitment required, and it would inform the public whether each director is satisfying this time commitment.

As a practical matter, requiring disclosure of the time commitment required would likely serve to limit the number of directorships that a non-executive director may hold because, done properly, the job of a non-executive director is quite demanding.

Question 8: Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

Yes, we believe that listed companies should not only be encouraged – but should also be required within the “comply or explain” framework – to conduct a triennial external evaluation. If a company chooses not to do this, it should be required to explain why not.

In terms of how such an external evaluation could be done, we believe that this external evaluation should be focused on not just whether the board has reached its decisions after proper consideration and due process, but also whether or not the board has the proper skills and expertise to lead the company in the future. In this manner, such an evaluation would be linked more to a forward-looking strategy, and less on past performance. The board should publish a statement that describes when and how an evaluation was conducted.

Question 9: Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Yes. Disclosure of remuneration policy, the annual remuneration report and individual remuneration of executive and non-executive directors (and executive management) should be mandatory within the “comply or explain” framework. Any corporate governance code should require the presence of a remuneration committee that is comprised by a majority of independent non-executive directors.¹⁴

The remuneration of directors must contain appropriate incentives to align the interests of directors with that of the company and its shareholders. If this does not happen, directors will profit at the expense of the true owners of the company.

¹⁴ Similar to its provisions with respect to the nominating committee, the Greek Code states that the board should establish a remuneration committee, which should be composed entirely of non-executive directors, the majority of whom should be independent. The Code also sets forth responsibilities of the remuneration committee.

As a result, the remuneration policy and public disclosures should be of sufficient detail to allow shareholders to ascertain whether the appropriate incentives are present. We suggest that in addition to disclosing individual remuneration of directors, there should also be disclosure of matters such as:

- policies to align reward with performance over time
- maximum aggregate pay
- clawback provisions to repay a bonus to a company in the event of certain circumstances such as leaving the company within a specified time period of subsequent losses
- a description of the desired balance between basic pay and short and long term bonuses
- a description of the desired methods of satisfying remuneration which could include a mix of cash, shares, share options and other forms of remuneration
- where a company issues options, disclosure of the option terms including vesting conditions, exercise period and maximum amounts.

The remuneration policy should apply to the CEO and the highest-ranking executives of the company, and it should include disclosures of the remuneration of these executives.

Question 10: Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

Greater shareholder involvement in establishing remuneration policy is to be encouraged. Therefore, we believe that it should be mandatory within the “comply or explain” framework for there to be a vote by the shareholders on the remuneration policy and report.

Question 11: Do you agree that the board should approve and take responsibility for the company’s ‘risk appetite’ and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

Yes. The board should approve and acknowledge collective responsibility for risk appetite, profile and strategy, and for periodic review of this. Such a requirement would be consistent with what is being required in specific countries. For example, the UK 2010 Governance Code has introduced a new principle regarding the board’s responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives.

We also believe that the company’s risk appetite, profile and strategy should be reported to shareholders, and on specific matters the board or the risk committee may wish to consult with shareholders. Matters such as risk identification, risk assessment and risk mitigation will often form meaningful elements of communication by the board to shareholders.

As we have stated previously, companies can improve the quality of their disclosures by, among other things:

- introducing greater connectivity between the company strategy, risk management and key performance indicators used to measure performance; and
- providing greater insight into how companies oversee the effectiveness of risk management and internal control throughout the year.¹⁵

The board should consult experts, delegate and receive reports where appropriate, and the board should also have the power to create a risk committee.

We do not believe that there should be a distinction between risks related to the company's business and operations, and key societal risks. A company should report on key societal risks to the extent that they are risks to the business.

Question 12: Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

Yes. Please see our response to question 11 for further detail.

Shareholders

Question 13: Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

We are not aware of any existing EU rules that may contribute to inappropriate short-termism among investors. We note that it is difficult to legislate against all short-termism, as short-term trading helps with liquidity, which is necessary for raising capital.

Question 14: Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

Yes. A stewardship code could help with incentive structures and performance evaluation of asset managers who manage long-term institutional investors' portfolios. We have observed that different divisions or groups within institutional investors/asset managers often focus on different aspects of companies. For example, one group may focus on corporate governance and another may focus on investment decisions, and often the two have differing goals. A stewardship code may bring about greater engagement amongst these groups.

International stewardship codes are preferable to national codes because companies and investors operate internationally. Adherence to a code of stewardship could help to raise the quality of shareholder engagement with their investee companies.

¹⁵ See Grant Thornton UK 2010 Corporate Governance Review at page 3.

Question 15: Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

Yes. As noted in the response to question 14, a stewardship code could help promote more effective monitoring of asset managers by institutional investors.

Question 16: Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

A stewardship code could help with the independence of asset managers and management of conflicts. We do not believe that EU wide rules are necessary.

Question 17: What would be the best way for the EU to facilitate shareholder cooperation?

Again, a stewardship code would be appropriate to help facilitate shareholder cooperation.

Question 18: Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

Yes. We support transparency, and believe that a code of conduct at the EU level would be worthwhile. We note that other participants in the capital markets are subject to regulations and codes of conduct with respect to conflicts of interest (eg, auditors). As noted above, we believe that there should be corporate governance rules for companies and a stewardship code for investors. Because proxy advisors are also participants in the capital markets, a code of conduct would likewise be appropriate.

Question 19: Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

No, we would not support legislative measures to restrict the ability of proxy advisors to provide consulting services to investee companies. However, per the code of conduct referenced in question 18, this is a matter that should be fully disclosed publicly.

Question 20: Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

We believe that increased dialogue between issuers and their shareholders is an essential aspect of corporate governance, and we believe that there should be a consistent framework across Europe for identifying shareholders who hold a certain percentage of the issuer's shares. However, we have no specific suggestions in this regard.

Question 21: Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

We believe that minority shareholders should be protected, and there should be consistent regulations across Europe. However, we do not have a position as to the necessity of creating additional minority rights beyond those that currently exist.

Question 22: Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

Similar to our response to question 21, we believe that there should be protections for minority shareholders from related-party transactions in a consistent way across Europe, but we do not have a position as to the necessity of creating additional protections beyond those that currently exist.

Question 23: Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

As noted in this green paper, employee share ownership is common in some European Member States. As the paper notes, while employee share ownership can align the incentives of employee with the long-term success of the company, there are also potential risks from employee share ownership, which can include an inappropriate focus on short-term goals, depending on how the share ownership is structured, as well as a lack of diversification in that an employee would both work for and invest in the same company.

We do not support measures at the EU level to promote employee share ownership. This is a decision primarily for individual companies – with input from their shareholders – and secondarily for individual Member States.

Monitoring and implementation of Corporate Governance Codes

Question 24: Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Yes. We support the “comply or explain” framework for corporate governance codes. In such a framework, companies must provide a detailed explanation when they choose not to comply with a particular portion of the code. As noted in the main body of our letter, the “comply or explain” framework is especially suited to the different levels of maturity in the corporate governance models throughout Europe, and will assist with further improvements to corporate governance.

Question 25: Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

Yes, we believe that monitoring bodies should be authorised to check the informative quality of explanations and should be empowered to require companies to provide more appropriate explanations when necessary. In order for the comply or explain mechanism to be sufficiently rigorous, there should be some sort of external check on compliance with corporate governance codes and the quality of explanations if a company elects not to comply. Sanctions should also be available.

However, we caution that monitoring bodies should take care not to establish too much prescriptive guidance when reviewing compliance with the governance code, as this could lead to boilerplate disclosures. In addition, different Member States have different oversight structures, bodies and rules; therefore, it would be difficult to prescribe a single method for monitoring bodies to oversee the explanations.