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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,

Draft

COMMISSION RECOMMENDATION

of [...]

**on fostering an appropriate regime
for the remuneration of directors of listed companies**

(Text with EEA relevance)

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(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 211 thereof,

Whereas:

- (1) In May 2003, the Commission adopted a Communication on “Modernising Company Law and enhancing Corporate Governance in the European Union – A Plan to Move Forward”¹. Among a range of proposals to strengthen shareholders’ rights and modernise the board of directors, it provides for an initiative aimed at encouraging the implementation of an appropriate regulatory regime on directors’ remuneration in the Member States.
- (2) The form, structure and level of directors’ remuneration are a matter in competence of companies and their shareholders. This should enable recruitment and retaining of directors meeting the quality criteria required to run a company. However, remuneration is one of the key areas where executive directors may have a conflict of interest and where due account should be taken of the interests of shareholders. Remuneration systems should therefore be subjected to appropriate governance controls, based on adequate information rights. In this respect, it is important to respect fully the diversity of corporate governance systems within the Community, which reflect different Member States’ views about the roles of corporations and of bodies responsible for the determination of directors’ remuneration policy and individual directors’ remuneration.
- (3) The disclosure of accurate and timely information by security issuers builds sustained investor confidence and constitutes an important tool for promoting sound corporate governance throughout the Community. To that end, it is important that listed companies ensure appropriate transparency towards investors to enable them to express their views.
- (4) When implementing this Recommendation, Member States should consider the specificities of collective investment undertakings of the corporate type and avoid unnecessary unequal treatment between collective investment undertakings of different legal nature. Regarding collective investment undertakings as defined in the

¹ COM(2003) 284 final

Directive 85/611/EEC, as amended by Directives 2001/107/EC and 2001/108/EC, the latter Directive already provides for a set of specific governance mechanisms. To avoid unnecessary unequal treatment of other collective investment undertakings of the corporate type not subject to EU-harmonisation, Member States should take into account whether and to what extent these non-harmonised collective investment undertakings are subject to equivalent governance mechanisms.

- (5) Shareholders should be provided with a clear and comprehensive overview of the company's remuneration policy. Such disclosure would enable shareholders to assess a company's approach to remuneration and strengthen company's accountability to shareholders. It should include elements related to compensation. This should, however, not lead the company to disclose any information of a commercially-sensitive nature which could be detrimental to the company's strategic position.
- (6) Adequate transparency should also be ensured in the area of directors' contracts policy. This should include the disclosure of information on issues like notice periods and termination payments under such contracts which are directly linked to directors' remuneration.
- (7) In order to give shareholders an effective means to express their views and an opportunity to debate the remuneration policy on the basis of a comprehensive disclosure, without having to initiate the process of tabling shareholders' resolution, the remuneration policy should be an explicit item on the agenda of the annual general meeting.
- (8) In order to increase accountability, the remuneration policy should be submitted to the annual general meeting for a vote. The vote at that meeting could be advisory, so that the rights of the relevant bodies responsible for directors' remuneration would not be altered. An advisory vote would not bring any obligation either to amend directors' contractual entitlements or to amend the remuneration policy.
- (9) Shareholders should also be provided with the information on the basis of which they can hold individual directors accountable for the remuneration they earn or have earned. Disclosure of the remuneration of individual directors of the company, both executive and non-executive or supervisory directors, in the preceding financial year is therefore important to help them appreciate the remuneration in the light of the overall performance of the company.
- (10) Variable remuneration schemes under which directors are remunerated in shares, share options or any other right to acquire shares or to be remunerated on the basis of share price movements, and any substantial change in such schemes, should be subject to the prior approval of the annual general meeting. The approval should relate to the scheme of remuneration and the rules applied to establish the individual remuneration under the scheme but not to the individual remuneration of directors under the scheme.
- (11) In view of the importance attached to the question of remuneration of directors it is appropriate to monitor compliance with this recommendation and in case of insufficient compliance to consider further measures,

HEREBY RECOMMENDS:

SECTION I: SCOPE AND DEFINITIONS

1. SCOPE

- 1.1. Member States should take all appropriate measures to ensure that listed companies having their registered office in their territory comply with this recommendation. They should however duly consider the specificities of collective investment undertakings of the corporate type under the scope of Directive 85/611/EEC of the Council², as amended by Directives 2001/107/EEC³ and 2001/108/EEC⁴ of the European Parliament and the Council. Member States should also consider the specificities of collective investment undertakings of the corporate type which are not subject to these directives and which sole purpose is the investment of money raised from investors in a diversified range of assets and which do not seek to take legal or management control over any of the issuers of its underlying investments.
- 1.2. Member States should also take all appropriate measures to ensure that listed companies which are not incorporated in one of the Member States but have their primary listing on a regulated market established in their territory comply with the provisions of this recommendation.
- 1.3. Member States should ensure that this recommendation applies to the remuneration of the chief executive officers in case that they are not members of the administrative, managerial and supervisory bodies of a listed company.

2. DEFINITIONS FOR THE PURPOSES OF THIS RECOMMENDATION

- 2.1. “Director” means any member of the administrative, managerial and supervisory bodies of a listed company.
- 2.2. “Listed company” means a company whose securities are admitted to trading on a regulated market within the meaning of Directive 2004/39/EEC of the European Parliament and of the Council⁵.

SECTION II: REMUNERATION POLICY

3. DISCLOSURE OF THE DIRECTORS’ REMUNERATION POLICY

- 3.1. Each listed company should disclose a statement of the remuneration policy of the company (“the remuneration statement”). It should be part of a self-standing remuneration report and/or be included in the annual accounts and annual report or in the notes to the annual accounts of the company. The remuneration statement should also be posted on the listed company’s website.
- 3.2. The remuneration statement should mainly focus on the company’s policy on directors’ remuneration for the following financial year and, if appropriate, the subsequent years. It should also contain an overview of the manner in which the

² OJ L 375, 31.12.1985 p.3.

³ OJ L 41, 12.02.2002, p.20

⁴ OJ L 41, 12.02.2002, p.35

⁵ OJ L 145, 30.4.2004, p.1.

remuneration policy has been implemented in the previous financial year. Particular emphasis should be put on any significant changes in the listed company's remuneration policy compared to the previous financial year.

- 3.3. The remuneration statement should include at least the following information :
- (a) explanation of the relative importance of the variable and non-variable components of directors' remuneration;
 - (b) sufficient information on the performance criteria on which any entitlement to share options, shares or variable components of remuneration is based;
 - (c) sufficient information on the linkage between remuneration and performance;
 - (d) the main parameters and rationale for any annual bonus scheme and any other non-cash benefits;
 - (e) a description of the main characteristics of supplementary pension or early retirement schemes for directors.

The disclosure of that information in the remuneration statement should nevertheless not entail the disclosure of information of a commercially-sensitive nature.

- 3.4. The remuneration statement should also summarise and explain the listed company's policy with regard to the terms of the contracts of executive directors. This should include, inter alia, information on the duration of contracts with executive directors, the applicable notice periods and details of provisions for termination payments and other payments linked to early termination under contracts for executive directors.
- 3.5. The information concerning the preparatory and decision-making process used for determining the listed company's remuneration policy for directors should also be disclosed. This should include information about, if applicable, the mandate and composition of a remuneration committee, the names of external consultants whose services have been used in determination of the remuneration policy and the role of the shareholders' annual general meeting

4. SHAREHOLDERS' VOTE

- 4.1. Without prejudice to the role and organisation of the relevant bodies responsible for setting directors' remunerations, the remuneration policy or every significant change to the remuneration policy should be an explicit item on the agenda of the annual general meeting.
- 4.2. Without prejudice to the role and organisation of the relevant bodies responsible for setting directors' remunerations, the remuneration statement should be submitted to the annual general meeting of shareholders for a vote. The vote may be either mandatory or advisory.

Member States may however provide that such a vote will be organised only if shareholders representing at least 25 percent of the total number of votes held by shareholders present or represented at the annual general meeting request it. The latter

should nevertheless be without prejudice to the right for shareholders to table a resolution in accordance with national provisions.

- 4.3. The listed company should inform shareholders entitled to be sent notice of the meeting about the intention to table a resolution approving the remuneration statement at the annual general meeting.

SECTION III: REMUNERATION OF INDIVIDUAL DIRECTORS

5. DISCLOSURE OF THE REMUNERATION OF INDIVIDUAL DIRECTORS

- 5.1. The total remuneration and other benefits granted to individual directors over the relevant financial year should be disclosed in detail in the annual accounts or in the notes to the annual accounts or, where applicable, in the remuneration report.
- 5.2. The annual accounts or the notes to the annual accounts or, where applicable, the remuneration report should show at least the information listed in points 5.3 to 5.6 for each person who has served as a director of the listed company for the relevant financial year at any time during that year.
- 5.3. Concerning the remuneration and/or emoluments, the following information should be presented:
 - (a) the total amount of salary paid or due to the director for the services performed under the relevant financial year, including where appropriate the attendance fees fixed by the annual general shareholders meeting;
 - (b) the remuneration and advantages received from any undertaking belonging to the same group;
 - (c) remuneration paid in the form of profit sharing and/or bonus payments and the reasons why such bonus payments and/or profit sharing were granted;
 - (d) where legally allowed, any material or significant additional remuneration paid to directors for special services outside the scope of the usual functions of a director;
 - (e) the compensation paid to or receivable by each former executive director in connection with the termination of his activities during that financial year;
 - (f) total estimated value of non-cash benefits considered as remuneration other than those covered in points (a) to (e).
- 5.4. Concerning shares and/or rights to acquire share options and/or all other share-incentive schemes, the following information should be presented:
 - (a) the number of share options offered or shares granted by the company during the relevant financial year and their conditions of application;

- (b) the number of share options exercised during the relevant financial year and for each of them the number of shares involved and the exercise price or the value of the interest in the share incentive scheme at the end of the financial year;
 - (c) the number of share options unexercised at the end of the financial year; their exercise price, the exercise date and the main conditions for the exercise of the rights;
 - (d) any change in the terms and conditions of existing share options during the financial year.
- 5.5. Concerning supplementary pension schemes, the following information should be presented
- (a) when the pension scheme is a defined-benefit scheme, changes in the director's accrued benefits under that scheme during the relevant financial year;
 - (b) when the scheme is a defined-contribution scheme, details of the contributions paid or payable by the listed company in respect of that director during the relevant financial year.
- 5.6. If allowed by national law or by the Articles of Association of the listed company, those amounts should be shown, which the company or any subsidiary or company included in the company's consolidated annual accounts, has paid for loans, advance payments and guarantees to each person who has served as a director at any time during the relevant financial year, including the amount outstanding and the interest rate.

SECTION IV: SHARE-BASED REMUNERATION

6. SHAREHOLDERS' APPROVAL

- 6.1. Schemes under which directors are remunerated in shares, share options or any other right to acquire shares or to be remunerated on the basis of share price movements should be subject to the prior approval of shareholders by way of a resolution at the annual general meeting prior to their adoption. The approval should relate to the scheme in itself and not to the grant of such share-based benefits under that scheme to individual directors.
- 6.2. Approval by the annual general meeting should be obtained for the following:
- (a) grant of share-based schemes, including share options, to directors;
 - (b) the determination of their maximum number and the main conditions of the granting process;
 - (c) the term within which options can be exercised;
 - (d) the conditions for any subsequent change in the exercise price of the options, if appropriate and legally allowed;

- (e) any other long term incentive schemes for which directors are eligible and which is not offered under similar terms to all other employees.

- 6.3. The annual general meeting should also set the deadline within which the body responsible for directors' remuneration can award these types of compensation to individual directors.
- 6.4. Any substantial change in the terms and conditions of the schemes should also be subject to the approval of shareholders by way of a resolution at the annual general meeting prior to their adoption. In those cases, shareholders should be informed about the full terms of the proposed changes and be given an explanation of the effect of the proposed changes.
- 6.5. If allowed by national law or by the Articles of Association of the listed company, any discounted option arrangement under which any rights are granted to subscribe to shares at a price lower than the market value of the share on the date when the exercise price is determined, or the average of the market values over a number of days preceding the date when the exercise price is determined, should also receive the approval of shareholders.
- 6.6. Points 6.1 to 6.4 should not apply to schemes in which participation is offered on similar terms to employees of the listed company or any of its subsidiary undertaking whose employees are eligible to participate in the scheme and which has been approved by the annual general meeting.

7. INFORMATION

- 7.1. Prior to the annual general meeting where a draft resolution is tabled in accordance with point 6.1 and in accordance with national law and/or the Articles of Association of the listed company, an information notice concerning the resolution should be made available to shareholders. It should at least contain the full text of the share-based remuneration schemes or a description of their principal terms, and the names of the participants in the schemes. The notice should also set out the relationship of the schemes with the overall directors' remuneration policy. The draft resolution should clearly refer either to the scheme itself or to the summary of its principal terms.
- 7.2. Information should also be made available to shareholders about how the company intends to provide for the shares needed to meet its obligations under incentive schemes. In particular it should be clear whether the company intends to purchase the necessary shares in the market, holds them in treasury or whether it will issue new shares.
- 7.3. This information should also provide an overview of the costs of the scheme to the company in view of the intended application.
- 7.4. Such information could be posted on the listed company's website.

8. FINAL PROVISIONS

- 8.1. The Member States are invited to take the necessary measures to promote the application of this recommendation by 30 June 2006 and to notify the Commission of measures taken in compliance with this Recommendation in order to allow the

Commission to monitor closely the situation and, on this basis, to assess the need for further measures.

8.2. This recommendation is addressed to the Member States.

Done at Brussels,

For the Commission
Member of the Commission