

**Synthesis of the comments on the Consultation Document of the  
Services of the Internal Market Directorate General**

**“Fostering an Appropriate Regime for the Remuneration of  
Directors”**

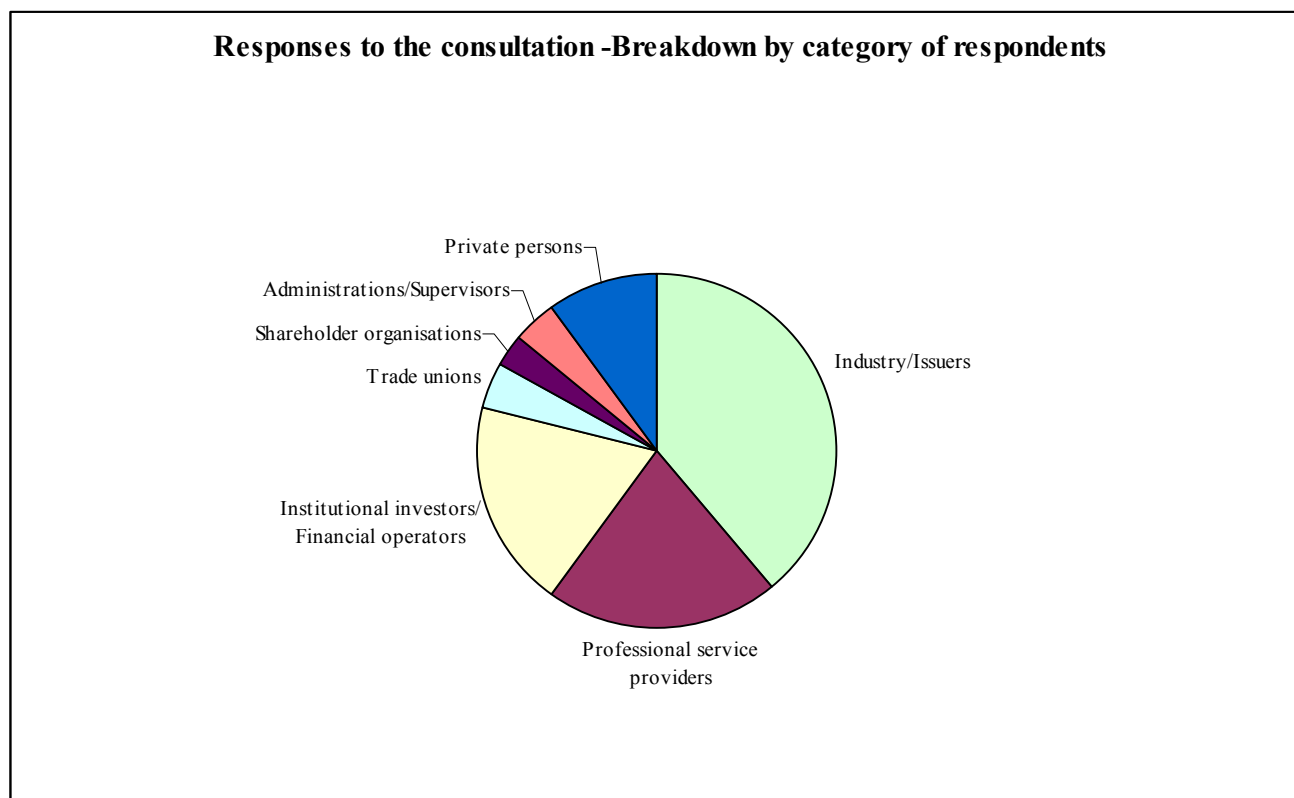
**A Working Document of DG Internal Market**

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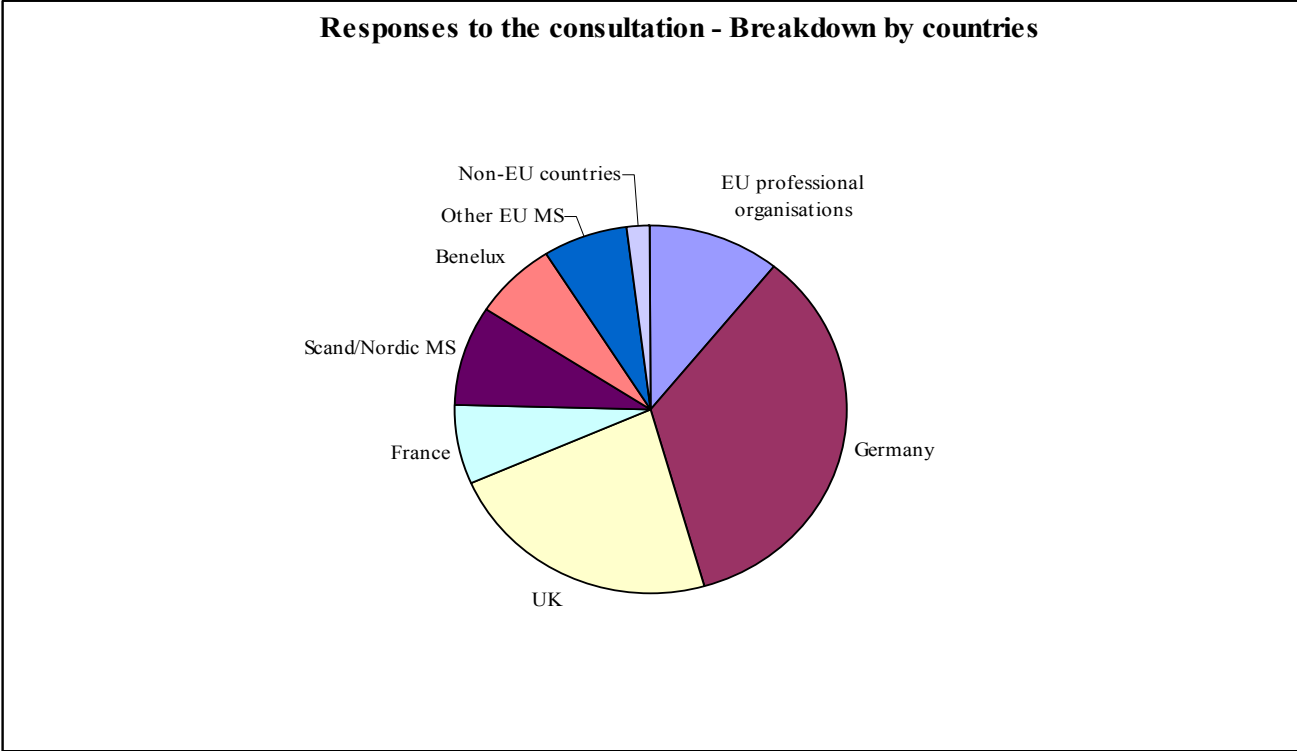
## Introduction

On February 23, 2004, the Services of the Internal Market Directorate General (hereinafter – IMDG) launched a public consultation on a document “Fostering an Appropriate Regime for the Remuneration of Directors”. The aim of the public consultation was to collect the views of interested parties on the possible content of the forthcoming recommendation on fostering an appropriate regime for the remuneration of directors (hereinafter - Recommendation).

101 contributions were received from a full cross-section of industry representatives, institutional investors, professional services providers (auditors, accountants or lawyers), shareholder protection organisations and trade unions. Some national administrations and financial services supervisory authorities also submitted their comments.



There was a wide geographical coverage with respondents from 14 countries, including 12 EU Member States. A significant number of replies were received from representative organisations at EU level.



This report seeks to provide an objective presentation of the comments received by the Commission services in response to the consultation document.

It provides a synthesis of the positions most frequently advanced by respondents in respect of the questions raised in the consultation document and of the main arguments underpinning these positions.

When evaluating the overall level of support or, vice versa, opposition vis-à-vis a particular proposal presented in the consultation document, the Commission services were guided not only by the number of respondents expressing a particular point of view, but also by the extent to which the respondents were representative. For this reason, the report does not include statistical data.

The report will follow the structure of the Consultation Document.

**Question 1: Do interested parties agree that the recommendation should not deal with the issues of the amount and structure of the directors' remuneration?**

Respondents supported nearly unanimously the proposal not to interfere in the amount and structure of directors' remuneration. It was acknowledged that, for a multitude of legal, financial and fiscal reasons, the amount and structure of directors' remuneration had to be left to the decision of each individual company.

A large number of respondents demanded that the future recommendation reiterate the principles of contractual freedom and of non-interference in the determination of the amount and structure of directors' remuneration.

***Question 2: Do interested parties agree with the Commission that the recommendation should invite Member States to take the necessary regulatory measures to ensure that listed companies comply with all the provisions to foster an appropriate regime for directors' remuneration?***

A majority of respondents considered that the Commission should not invite Member States to adopt regulatory measures to ensure effective disclosure and strengthen shareholders' rights in the area of directors' remuneration. Member States should be granted discretionary powers to decide whether to implement the recommendation by means of legislation or, for example, self-regulation.

A majority of respondents considered that it was preferable to deal with the issues of directors' remuneration in codes of corporate governance rather than by introducing regulatory measures, since these would make it very difficult to make practice-oriented adjustments or take account of sector-specific factors. "Comply or explain" rules would allow capital markets and investors to sanction non-compliance and/or failures in management or supervision. Pressure of this kind was likely to be just as effective in terms of discouraging excess as legal compulsion, particularly if the company's auditor was required to play a part in monitoring compliance with the guidance.

A non-negligible minority of respondents considered that some sort of regulatory measures were needed. They considered that remuneration was one of the key areas where directors had conflicts of interests and opt-outs by companies could not be justified. There were obvious opportunities for less scrupulously managed companies to take advantage of voluntary regimes and creation of a level playing field was desirable. Furthermore, evidence from some EU Member States proved that encouraging greater disclosure by companies via a voluntary approach did not work because companies believed that they would be at a disadvantage relative to their competitors if they disclosed respective information and their peer group did not.

Some respondents also considered that legislation or formal regulation was best used when it was needed to support a voluntary code-based system. For example, Member States might perceive the need for some regulatory requirement on companies to make disclosures, but leave the details to be agreed through a voluntary consensual code.

***Question 3: Do interested parties share the view that the scope of the recommendation should cover EU listed companies or should it cover all EU companies?***

A vast majority of respondents considered that the recommendation should only cover listed companies. Nearly all respondents also rejected extension of the scope of application to all EU companies. The rationale for transparency of directors' remuneration policy was considered to be stronger in the case of listed companies given the public availability of their shares and the higher turnover of shareholders. Such rules would represent a considerable

burden for the great majority of smaller, unlisted companies and would be inappropriate for them. Another argument put forward was that a reason for not listing was often privacy; if that was what the shareholders wanted, this should be respected. In general, the information obligation under accounting directives was deemed sufficient (obligation to provide information on the global sum of directors' remuneration) as far as unlisted companies were concerned. Some respondents considered the recommendation should apply to all companies listed in the EU as opposed to EU listed companies with a registered office in one of the EU Member State.

A small number of submissions even asked for a narrower scope of application and considered the recommendation should not apply to the full extent to smaller quoted companies. They argued that such provisions might just add another layer of cost onto smaller quoted companies which could not afford it. The regulators ought to strike a cost/benefit balance and take account of the impact that regulation would have on small listed companies. In this respect existing differences in the rulebooks and the company law for the "official list" companies and companies on the junior markets were referred to. Introduction of new requirements should be carefully considered in order to avoid pushing smaller quoted companies out of the official list.

There were also a few claims to consider excluding from the scope of application of the Recommendation issuers whose presence on a regulated market was limited to bonds. In this case, investors' interest was supposed to be largely limited to solvency-related information of the issuer to ensure that his principal investment and the interest would be paid.

On the contrary, some respondents considered that the scope of the Recommendation should be widened to include disclosure at the level of the group and disclosure of companies of public interest, since breakdowns in the corporate governance of such companies could sometimes seriously undermine the confidence of capital markets.

***Question 4: Do interested parties share the view that this recommendation should deal with the remuneration of the members of the administrative, managerial and supervisory bodies by reason of their responsibilities?***

An overwhelming majority of respondents supported the definition of directors proposed in the consultation document which referred to the terms used in the EU accounting directives. The definition was generally recognised as appropriate to encompass the wide diversity of board structures prevailing in EU Member States.

Some respondents nevertheless requested a more precise definition to take due account of some national peculiarities.

Some respondents considered that the recommendation should not deal with the remuneration of the supervisory board members, since remuneration of supervisory directors was already decided by the Annual General Meeting and normally was negligible compared to remuneration of administrative/managing bodies.

Several respondents also stressed that the recommendation should deal with the remuneration of the CEO/managing director irrespective of him/her being a member of the board, as in some cases the CEO did not belong to any board structure. A few respondents also asked for the remuneration of individuals acting in the capacity of a board director (e.g. planning, directing and controlling the activities of the company), though not being formal members of the board, also to be covered by the recommendation.

**Question 5: Do interested parties agree that the disclosure of remuneration policy should be forward-looking (i.e. next financial year) and should contain at least the elements mentioned in the Consultation Document? Do they agree that such information should be a separate item on the AGM agenda? And should there be a requirement for at least an advisory vote on the remuneration policy at the Annual General Meeting?**

For the sake of clarity, responses to each of the aforementioned questions will be treated separately.

**Question 5.1: Do interested parties agree that the disclosure of remuneration policy should be forward-looking (i.e. next financial year) and should contain at least the elements mentioned in the Consultation Document?**

A significant majority of respondents welcomed the idea of the forward-looking disclosure of remuneration policy. This would allow shareholders to evaluate the incentive effect of the policy from the perspective of enhancing the company's performance and shareholder value and to guide the board in its work on the remuneration of directors. Quite obviously, forward-looking disclosure would enable policy to be amended before inappropriate awards were made. Some respondents considered that such a forward-looking statement should be accompanied by some disclosure on the way remuneration policy had been implemented in the previous financial year.

Respondents who expressed certain opposition to such a remuneration policy statement argued that disclosure of such comprehensive information might result in a disadvantage from the competition point of view: since details regarding performance criteria or contract policy were normally linked to the company strategy or were commercially sensitive and could not be disclosed to competitors. They also claimed that forward-looking disclosure of the remuneration policy was a complicated technical exercise and would result in considerable additional workload and financial burden for companies. Finally they stressed that it would impose unnecessary restrictions on the company's (supervisory) board's capacity to respond to changed circumstances, such as a major acquisition or difficulty in filling a director's vacancy.

A significant number of respondents asked for a greater flexibility as far as the content of the remuneration statement was concerned. They considered that the content of disclosure as proposed in the consultation documents was too exhaustive. Some requested that disclosure requirements be drawn up in such a way as to enable changing practice to be

accommodated. Thus, the elements listed in the consultation document might serve as guidance only. Alternatively, the recommendation might be limited to general principles and objectives, leaving the details to national codes and individual companies. Finally, a few respondents asked for more flexibility with respect to the frequency of disclosure. A well constructed policy would stand a much longer test of time than one year. It might also be sufficient to simply post the basic principles of remuneration policy on the company's web page and to update it when necessary.

On the contrary, a number of respondents considered that disclosure requirements needed to be more detailed and comprehensive. Some considered that information on the total remuneration that directors were about to receive should be part of the remuneration statement. Companies should set out clearly the expected remuneration outcome for median performance in relation to the comparator group. Shareholders needed to see clearly within what limits the policy would operate, to know how the dynamic elements like share options could develop in order to understand how much money the remuneration could amount to. Some respondents also claimed that the disclosure of the remuneration policy should be the same for executive and non-executive directors. A few respondents asked for more detailed information on, for instance, use of benchmarks to compare the performance of a company/director with that of a comparator group and the policy of including change of control clauses in the directors' contracts. Finally, it was stressed that the information regarding the circumstances under which a policy could be changed or amended by the board was as important as information about the policy itself.

Some respondents also commented on the place where the relevant disclosure would have to appear taking into account its implications for external audit. They emphasized that policy aspects of remuneration did not lend themselves to audit. If all remuneration-related information, including the factual data for the previous financial year, were to be included in a single document, namely, a remuneration report, it was considered advisable to split the report between those aspects that were to be audited and those that were not.

***Question 5.2: Do interested parties agree that such information should be a separate item on the AGM agenda?***

Respondents were evenly divided on the question of whether the remuneration policy statement should be a separate item on the AGM agenda. Those who supported mandating information on remuneration policy as a separate item on the AGM agenda considered that this would enhance the transparency of companies and the quality of disclosure. They also claimed that where there was already such a requirement, companies and shareholders were more involved in remuneration matters.

Those opposing the introduction of the mandatory obligation in this field argued that preparing the AGM agenda was a matter for the competent bodies in the company. Shareholders always had the opportunity to file a resolution and request additional items on the agenda. They also had the possibility to obtain information from "publicly available information sources" or annual accounts and management reports, which were subject to examination by the AGM. Respondents from Member States with a two-tier board system considered that it would be contrary to the institutional distribution of responsibilities to have

the General Meeting debate on executive directors' remuneration. Finally, some argued that the AGM was already quite lengthy and that new agenda items should not be taken up without proper reason.

***Question 5.3: Should there be a requirement for at least an advisory vote on the remuneration policy at the Annual General Meeting?***

A majority of respondents expressed their opposition to the introduction of a requirement to have a vote (even advisory) on the remuneration policy at the AGM. They considered that a vote by the AGM on remuneration policy would run against current practice in most Member States where remuneration was the responsibility of the body which appointed and evaluated the performance of the person concerned. This would imply that it was for the supervisory board alone to decide on remuneration of executive directors and that the AGM would decide only on remuneration of non-executive directors and members of the supervisory board. As far as an advisory vote was concerned, some argued that it could be misunderstood by shareholders. Moreover, some argued that this was not current practice in many Member States. Furthermore, they stressed that the remuneration policy touched upon a wide range of financial, economic and company-specific factors. Their analysis necessitated, together with professional knowledge, a high degree of understanding of the company's financial structure. Discussion or even voting on these issues would be reduced to superficial and emotional discussion of the remuneration sum and no justice would be done to the importance of the issue for the company. Some respondents thought that a requirement to vote could even undermine good functioning of the AGM, as it would detract attention from more important strategic issues. In addition, a few respondents considered that forcing the AGM to vote on the remuneration policy when the remuneration was often approved beforehand by the main owners would be a counter-productive rule.

Some respondents also considered that adequate disclosure and the chance to vote on the re-election of board members or of the chairman of the remuneration committee were sufficient instruments for enabling shareholders to exercise due influence.

A significant minority of respondents however supported the idea of a vote of the AGM on the remuneration policy statement. This could be generally regarded as a constructive instance of shareholder activism and as providing the right means to correct inappropriate remuneration policies. A number of respondents praised the flexibility of the approach proposed. A vote on policy would distance shareholders from the detail of individual remuneration packages, but Member States would still be able to go further and allow for circumstances when shareholders wanted to express a view on payments such as annual bonuses or compensation payments. Furthermore, an advisory vote would not require amendments to the existing contractual entitlements or the remuneration policy. The board would continue to have responsibility for remuneration matters, subject to the company's articles of association.

***Question 6: Do interested parties consider that the disclosure of the remuneration of individual directors should include all financial and non-financial benefits as***

***described in the Consultation Document? Do they consider that other information related to individual directors' remuneration should also be disclosed?***

A significant majority of respondents was in favour of the approach proposed in the consultation document. Because of the significant position of directors, it was important to provide shareholders with detailed information on their benefits so as to enable them to assess the amount and substance of remuneration in relation to the achievement of their prescribed objectives. Detailed disclosure was needed to deal with the problems of supervision and compliance. Experience of the last years clearly demonstrated that more transparency also lead to higher investor confidence.

Some respondents considered that the level of disclosure should be more detailed and exhaustive: a number of respondents highlighted the need to disclose all remuneration earned by directors not only as part of their responsibilities within the company, but also within its subsidiary undertakings. A large number of respondents considered that information on stock options should be widened to cover all long-term incentive plans. Some respondents also insisted on having the same level of disclosure for executive and non-executive directors, although it was acknowledged that in most cases there would be a significant difference in the volume of disclosure required. Advance payments, credits granted, guarantees provided, life insurance premiums paid, etc. should not be forgotten. Finally, many respondents reiterated that the total sum of remuneration (financial and non-financial) should be disclosed in any case.

A minority of respondents opposed such a level of disclosure for individual remuneration. They considered that the extent of disclosure of the remuneration of individual directors, if any, should be left to national Corporate Governance Codes as well as market forces. They also referred to the revised OECD principles, which did not involve the disclosure of individual management board members' remuneration. The following arguments were put forward: 1) what mattered to shareholders was the total amount of directors' remuneration, not individual remuneration; should such information be deemed insufficient by shareholders, they could always ask questions or table resolutions at the AGM; 2) individual disclosure might lead to an undesired tendency towards a levelling of remuneration differences and to some inflationary spiral; 3) detailed disclosure as proposed in the consultation document would interfere with personal data protection and privacy rights. It might lead to social tension within the company and make collective bargaining more difficult.

Some respondents also made alternative proposals for disclosure: disclosure of remuneration levels by defined groups of directors or on an anonymous basis; disclosure of individual remuneration of only the key representatives of management e.g. the top five paid executives.

As far as disclosure details were concerned, the following comments were frequently made:

- Bonuses: there was a need to take into account that they were not necessarily fixed;
- Stock options: to enable informed judgement on this type of remuneration, inclusion of the information on the price paid for their award and the exercise price was needed; furthermore, disclosure of details of total options held by directors, instead of a simple

disclosure of those granted during the relevant financial year might be more appropriate.

- Variable remuneration in general: it should be included in the annual financial statement for the year to which this remuneration related (not for the year when it was actually paid).
- Supplementary pension schemes: only special measures aimed at directors should be disclosed. Additional information should also be given on capital value of the pension scheme accruals at the end of the financial year.

Finally, a number of respondents also pointed out the need for the Recommendation to be coordinated with adjacent rules, *inter alia* accounting standards (IAS 19 and IAS 24).

**Question 7: Do interested parties agree that grants of share-based schemes to directors should be subject to the prior approval of the general meeting of shareholders and that relevant information on such schemes should be communicated to shareholders prior to the meeting?**

A large majority of respondents were in favour of the approach proposed in the consultation document regarding shareholders involvement in the approval of share-based remuneration schemes to directors.

They considered this was a fundamental shareholder right since share-based remuneration schemes could give rise to serious conflicts of interest and abuses of corporate assets. They highlighted that share-based remuneration schemes could – through share dilution – affect the legal position of shareholders (loss of majority or of minority thresholds allowing them to exercise their minority rights), not to mention their economic interests. Such a mechanism would not only serve to counter any tendency to excessive and unnecessary share-based remuneration, it would also provide shareholders with an appropriate sanction over dilution levels.

Some respondents considered that the recommendation should detail the information shareholders needed to vote on in cases of stock options grant. The proxy material would have to include all relevant information: the basis on which awards would be made together with the level of maximum award, performance targets, any retesting provisions, comparator groups used, vesting scales, change-in-control or retirement provisions, the source of shares to be used, dilution implied by the scheme on vote, and the total dilution implied by the sum of all the existing schemes, etc.

Some respondents pointed out the need for clarity over the extent to which the (supervisory) board's remuneration committee/ supervisory board would be entitled to exercise discretion over *inter alia* the size of grants or their vesting, as this would be an important consideration in shareholder voting decisions.

A very small minority of respondents were totally opposed to the approach proposed in the consultation document. They considered that the AGM involvement in decisions on capital

increases and acquisitions of own shares, as laid down by the Second Company Law Directive, was sufficient. In their view, extending shareholders' involvement any further would hinder necessary flexibility and may be to the detriment of the company's competitiveness. They were confident that transparency afterwards would be sufficient for shareholders and financial markets to correct excesses.

A number of respondents who recognized the need for the AGM's involvement in the grant of share-based schemes considered that the AGM should not be asked to approve the performance criteria. Some also highlighted the price-sensitive nature of the relevant information. The role of the AGM should be limited to authorising the attribution of stock-options, to fixing the maximum number of options to be attributed and to approving the general modalities for such attribution. It should be left to the board (remuneration committee) to approve the content of the schemes as well as the detailed allocation terms.

A few respondents commented on the AGM's role in cases of subsequent change to the rules of share-based remuneration schemes. Some considered that the remuneration committee or the board should have only limited discretion to change the rules of the scheme and that any substantial change to the benefit of the participants (performance targets, comparator groups or award levels) should be submitted to shareholders for approval. Others requested greater flexibility in certain cases. For instance, many share-based remuneration schemes were subject to frequent minor revisions to comply with changes in tax legislation or other regulatory requirements. The obligation to seek shareholder approval in all such circumstances might prove extremely onerous.

Finally, some respondents requested that shareholders' involvement should be extended to the granting of variable remuneration schemes involving non-equity remuneration on the basis of share price movements. Others argued that shareholders would not be affected to the same extent as in the case of share-based remuneration schemes.

## **Conclusion**

DG MARKT wishes to thank all respondents for their valuable and high quality contributions.

Although in this document it has proved impossible to record all details of the suggestions expressed, the Commission will keep them in mind when working on the future recommendation.

DG MARKT apologises if any of the arguments advanced have not been reflected precisely enough due to possible translation errors or other reasons.