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SHAREHOLDER RIGHTS DIRECTIVE

REMUNERATION

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Summary:

Our main concerns are:

1. **The remuneration report should be mainly about disclosure, while Member States should have the freedom to choose between an ex ante or an ex post vote, to be included either in soft law or in hard law. However, it is important that disclosure of financial and non-financial remuneration components should not harm companies' interests;**
2. **We question whether shareholders have the resources to decide on the details of remuneration or whether they will rely more on their advisers; if they are asked to vote, then advisory votes may bring better results than binding ones;**
3. **There are practical difficulties in the calculation and interpretation of a pay ratio, as well as a threat of ending up with a 'one size fits all' solution, therefore, the provision to disclose this ratio should be deleted both in the remuneration policy and in the remuneration report.**

Introduction

While understanding the goal of the European Commission to better align executive pay with corporate objectives and performance, European companies are concerned that the proposal on 'say on pay' may not meet this objective.

At the same time, some of the proposals may cause operational difficulties and impose additional costs on companies at a time when the competitiveness of the European Union, which relies on the performance and growth of its companies, is very much needed.

The *ex ante* binding vote and the *ex post* vote

A binding vote on the remuneration policy would lead to a shift of power towards shareholders, even though it is the Board of Directors that should remain responsible for negotiating and determining the remuneration of executive directors.

We would also question whether issues relating to executive remuneration may not involve technical aspects that cannot easily be dealt with by the general meeting. A large number of shareholders will not have the expertise needed, the interest to decide on technical remuneration matters, nor the capacity to deal with the additional work. Lack of resource is already a major reason for institutional investors to ask for opinions from one or even more proxy advisors for each resolution.

In addition, the ex ante and ex post votes overlap to some extent and could be contradictory. This would lead to a paradox, given that the remuneration report is based on the previously approved remuneration policy. In companies with high shareholder turnover, the people voting on the policy could be different from those voting on the policy report.

Therefore, the remuneration report should be mainly about disclosure (especially since there is some evidence that advisory votes can bring better results than binding ones[1]) and Member States should be free to choose between an ex ante or an ex post vote to be included either in soft law or in hard law. The directive should therefore be more principle based and less prescriptive.

Vote on remuneration policy

The proposal has set up a binding say on pay on the remuneration policy, while we are convinced that **an advisory vote would be effective enough**. It would be difficult for the Board of Directors to ignore a warning given by shareholders.

When recruiting a new board member, the proposal foresees that companies can decide to pay remuneration outside the approved policy, but at the same time, requires prior approval, which is unclear. Such provisions may deter some competent and qualified CEOs from joining European companies, if they have the feeling that the level of remuneration they have negotiated may be called into question.

In any case, in order to allow the board of directors (supervisory board in some jurisdictions) to properly address shareholders' concerns, to improve its proposals and to attribute a major role to the remuneration committee, it is important that investors, who vote against a resolution, disclose their motivations.

Shareholders may vote against a remuneration report for different reasons, which may be contradictory and not necessarily linked to remuneration (for instance, they may oppose the combination of the functions of Chairman and CEO and choose to vote against the remuneration report on this issue).

Disclosure of shareholder motivations would be especially important for companies with dispersed ownership, as they are more likely to face problems determining shareholders' expectations.

[1] See e.g. David F. Larcker, Allan L. McCall, Gaizka Ormazabal, Brian Tayan "Ten Myths of 'Say on Pay'", Stanford Graduate School of Business, 2012

As mentioned earlier, we would also like to point out a possible inconsistency between an approval vote on the remuneration policy and disapproval of the remuneration report. The question would be how to deal with cases where the remuneration reported is the result of principles and mechanisms set up and approved under the remuneration policy. This can be particularly complicated in the case of significant changes in company ownership, which may result from mergers and acquisitions, or a high level of turnover in shares, due to short-term trading strategies. **That is why Member States should be able to choose to impose either an ex ante vote or an ex post vote.**

Remuneration policy components

EuropeanIssuers would also like to point out some components of remuneration policy listed in the proposal, which may be problematic:

- **The requirement of defined maximum amounts that can be awarded by the AGM**

Publishing the planned envisaged maximum amount that can be awarded by the AGM would seriously interfere with the negotiations of the remuneration while hiring new directors and senior management. This would lead, for the first time in the history of private law, to a statutory obligation of disclosure of the negotiating framework of one of the parties which would be clearly to the detriment of company's interests. The candidate for e.g. the Management Board would now know exactly how much remuneration the company is prepared to pay. Naturally, the candidate would then align his negotiations to the transparent maximum.

Moreover, if the aim of the Directive in the field of remuneration is to achieve a better link between pay and performance of (executive) directors, then fixing and publishing a maximum amount of total remuneration would imply that, over a certain performance level, the concerned director is not rewarded any more. This effect is contrary to the purported objective of the Directive.

For the reasons given above, **the provision to indicate the maximum of the total remuneration of directors should be deleted.**

- **Pay ratio**

EuropeanIssuers is also concerned about inclusion of a ratio between the remuneration of directors and the average remuneration of full time employees other than directors (articles 9a.3(b) and 9b.2(1)) in the remuneration policy and in the remuneration report.

The calculation of the ratio raises some practical difficulties. In the case of multinational companies, the employees of which are mostly located in countries with very low average cost of living (e.g. in Asia), this information may be misleading. On the other hand, if the Commission intends to limit the scope to employees located in the country where the company is registered, it might not give the right picture either. For instance, it may be that only 10 % of employees are located in that country, which is not unusual for international blue chip companies. This makes comparisons very difficult.

Moreover, in medium/large companies, remuneration policy depends on many factors including: company history, type of development, field of activity, strategy, organization of

production, subcontracting and outsourcing policy, distribution of categories of employees. This complex reality will make it difficult to compare ratios.

So we are not convinced that this measure will enhance the main aim of the Directive, which we understand is enhancing long term shareholder engagement. Instead, it risks having a distorting effect of aligning pay ratios, as investors – facing review of large numbers of compensation schemes in order to set their votes – will probably insist on a narrow range of pay ratios, thus forcing companies into a one-size fits all model that is, however, not suitable in this case. Therefore, we recommend that the **provision to disclose the said ratio should be deleted both in the remuneration policy and in the remuneration report**.

- **Financial and non-financial performance criteria regarding variable remuneration components**

Disclosing financial and non-financial performance criteria regarding variable remuneration components and the methods of calculation to determine to which extent the performance criteria have been fulfilled, especially related to targets of performance criteria for current or future fiscal years, could be problematic. These targets may refer to confidential business and operating matters of companies. Their public disclosure could therefore harm companies' interests, given that the information would then be available to competitors to draw their own conclusions. Those competitors might not, however, be obliged to make the same disclosures. **We therefore advise caution with regard to the information to be disclosed.**

<u>Remuneration report</u>

Scope

With regard to the scope of the remuneration report (article 9b.2), we would like to suggest the following drafting amendment in order to avoid potential confusion:

"Member States shall ensure that the remuneration report is clear and understandable, provides a comprehensive overview of the remuneration granted to individual directors in the last financial year ***by the company and its consolidated subsidiaries*** *and contains a summary of the remuneration policy on which it is based."*

Otherwise, we fear that some inconsistencies may arise with the Prospectus Regulation and Member States' rules.

EuropeanIssuers would also suggest that **the decision to disclose certain components of the remuneration report** required by the draft directive, like an explanation of how the performance criteria were applied and the remuneration awarded to each former director, **should rather be handled at the national level.**

Definition and instrument of disclosure

There is a need to provide a clear definition of the remuneration report, coherent with the Recommendation 2004/913.

In fact, according to the Recommendation (art. 3, par. 1, and 5 par. 1)), the "Remuneration report" includes in the first part the remuneration statement (with the remuneration policy) and in the second part the overview of the remuneration granted. This provision was implemented in many EU countries. In contrast, the proposed directive lacks an explicit definition and provides for a remuneration report only in art 9b referring just to the disclosure of the remuneration awarded.

We propose that the new SHRD **explicitly defines the remuneration report composed of two parts**: the first part a "remuneration statement" including the remuneration policy of the company (art. 9a); the second one should include the remuneration awarded (in art. 9b).

In addition, **we propose to keep the flexibility of the Recommendation** and allow companies to publish the remuneration report within the corporate governance statement or in the annual accounts or as a separate stand alone document, instead of obliging issuers to put the remuneration report in the corporate governance report. **Therefore, article 2 of the proposal should be deleted.**

Change of remuneration

The proposal requires provision of information on change of the remuneration of directors and its relation to the development of the value of the company (article 9b, para 1(b)). In order to avoid short-termism by the use of share price as the measurement of the company's value, we would suggest **reference to the evolution of the main financial ratios** applicable to the company, which show the real company performance.

Verification by auditors (Art. 2 amendments to directive (EU) n. 2013/34)

The draft provision requires that the remuneration report is a part of the corporate governance statement and the statutory auditors must check whether the information required has been provided. Given that all the information is public, this does not seem necessary and we would advocate for refraining from adding costs to European companies already facing competitive challenges comparing with companies overseas. **We would therefore recommend that auditors not be required to check the information.**