

Fixing Directors' Remuneration in Europe

Governance, Regulation and Disclosure

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COMMISSION RECOMMENDATION fostering an appropriate regime for the remuneration of directors of listed companies (14 December 2004)

Implementation by Member States: by 30 June 2006 through legislation or best practice rules (comply or explain)

4 measures:

- Disclosure of information on companies' remuneration policy, its structure and performance criteria in annual accounts
- Shareholders' vote on the remuneration policy at the general meeting: binding or advisory
- Disclosure of individual directors' remuneration package
- Prior approval of share option schemes

**COMMISSION RECOMMENDATION on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board
(15 February, 2005)**

Implementation by Member States: by 30 June 2006 through legislation or best practice rules (comply or explain)

4 measures:

- Separation of the role of CEO and (supervisory board) chairman
- A sufficient number of independent directors on the supervisory board; independence from the controlling shareholder
- The creation of nomination, remuneration and audit committees
- Strong presence of independent directors in board committees

Commission reports on the application by Member States of its recommendations (July 2007)

- Provide a general outline of the stage of implementation in Member States regulations

Overview

- Disclosure practices vary significantly across Europe
- Progress in improving governance standards
- Requirements on remuneration policy, individual directors' pay: applied by most Member States
- Recommendations aimed at giving shareholders more influence: not implemented by the majority of the Member States
- Wording of the corporate governance codes and the regulatory techniques reveal differences in the importance attached to different provisions

Research: European companies

Dataset

- FTSEurofirst 300 components (market cap); 16 European countries (14 EU)
- Analysis based on annual financial statements and corporate governance reports financial year Dec 07 / Mar 08

Methodology

- 3 areas: governance, remuneration policy and individual disclosure
- Set of 8 criteria and 23 sub-criteria for measuring the level of disclosure, following the two Commission Recommendations
Commission Recommendation fostering an appropriate regime for the remuneration of directors of listed companies, and
Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board

Degree of conformity: measures the extent to which companies follow international recommendations for the presentation and disclosure of their directors' remuneration policy.

Assessed:

- i) at a general level, comprising all firms from our dataset
- ii) at country level
- iii) at firm level

3 AREAS	8 CRITERIA	23 SUB-CRITERIA (rated 0 / 1)
GOVERNANCE	REMUNERATION COMMITTEE	Existence
		Composition
REMUNERATION POLICY	REMUNERATION POLICY STATEMENT	Statement: existent
		Overview of the policy
		Forward looking
	TERMS OF CONTRACTS EXECUTIVE DIRECTORS	Duration of contracts
		Notice periods
		Termination payments
	PREPARATORY AND DECISION MAKING PROCESS	Mandate and composition Remuneration Committee
		External consultants
		Role of the AGM
	POLICY: INFORMATION	Relative importance fixed-variable
		Main parameters and rationale annual bonus
		Performance criteria share-based remuneration
Sufficient information link remuneration - performance		
INDIVIDUAL DISCLOSURE EXEC. & NON-EXEC.	INDIVIDUAL DISCLOSURE	Individual disclosure executives
		Individual disclosure non-executives
	INDIVIDUAL EMOLUMENTS	Individual salary / fee
		Individual bonus and other benefits
		Information preceding year
	SHARE-INCENTIVE SCHEMES	Share options / shares granted
		Share options exercised
		Share options unexercised

Results

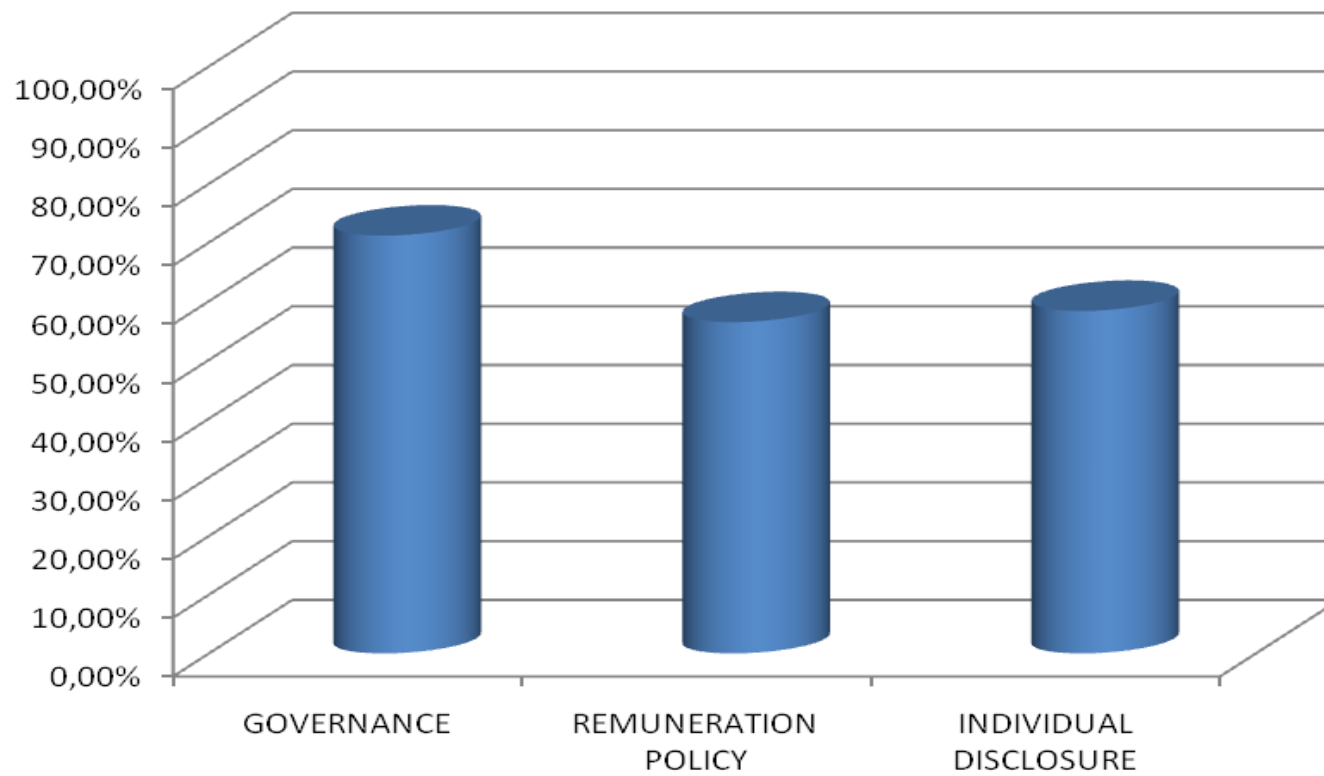
Overall degree of conformity

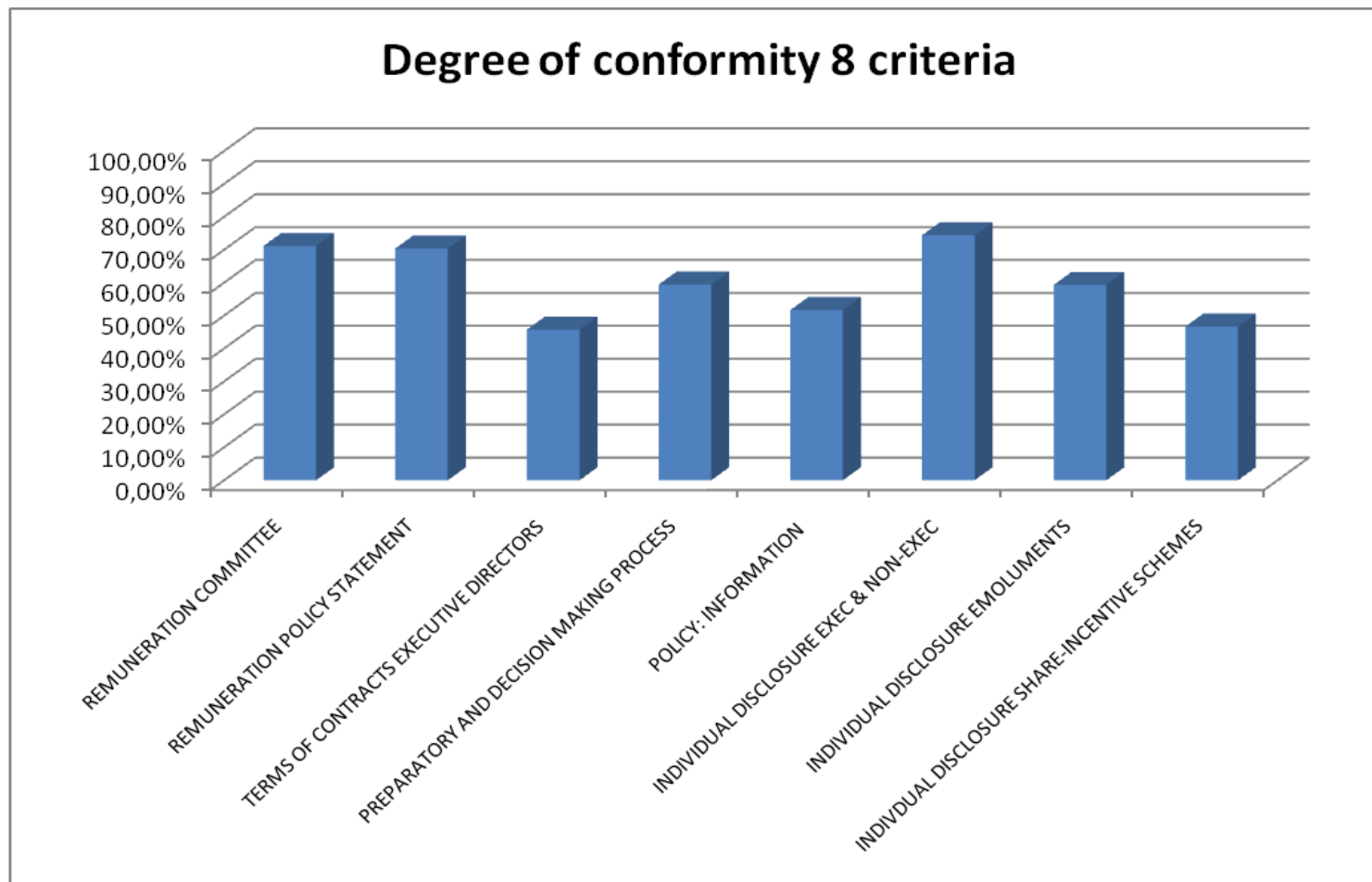
All firms: **58%**

Continental Europe (excluding UK): **48%**

Country	Number of firms	Overall degree of conformity
UK	64	95%
France	55	56%
Germany	34	47%
Spain	21	32%
Italy	20	51%
Switzerland	20	45.5%
Sweden	14	48%
The Netherlands	14	85%
Belgium	11	39%
Norway	8	57%
Austria	7	32%
Greece	7	16%
Portugal	5	35%
Denmark	5	33%
Ireland	5	70.5%
Finland	5	36.5%

Degree of conformity 3 main areas

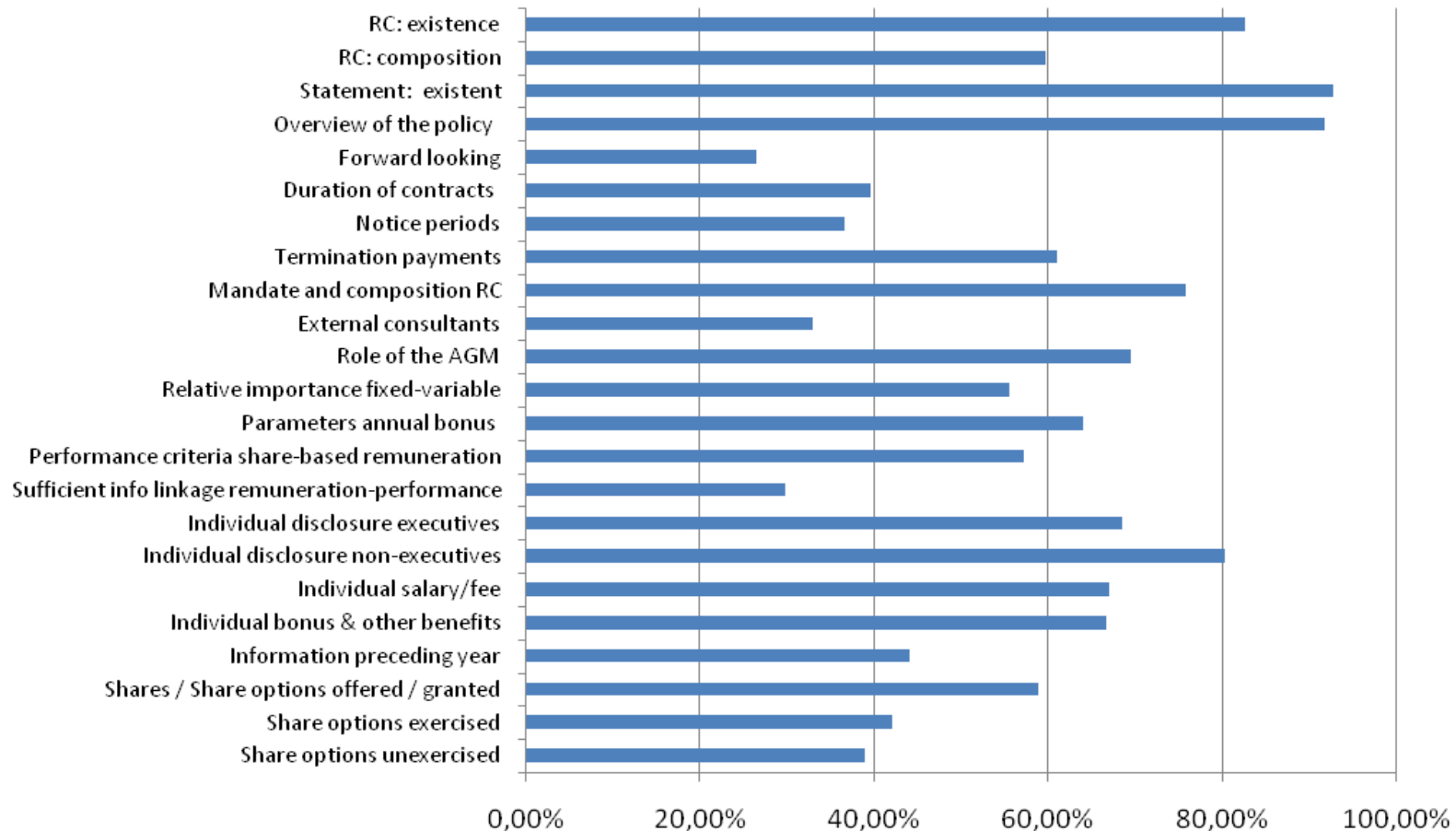




Highest: Individual disclosure executive and non-executive directors' remuneration
Remuneration Committee existence

Lowest: Information terms of contracts for executive directors

Degree of conformity 23 sub-criteria



Highest: Remuneration Committee existence, Statement existence

Lowest: Forward looking statement

External consultants

Information link remuneration - performance

Governance

Remuneration Committee

Existence

Most firms have separate Remuneration Committees or joined Nomination & Remuneration Committees

Some firms delegate responsibilities to other committees (e.g. Germany: HR Committee)

Composition

Not all Remuneration Committees are composed exclusively non-executive, majority independent directors

E.g. explanations for non-compliance:

“In the opinion of the Board it is important for the committee to have a member who has extra long experience of remuneration issues and investor’s business”. (Swedish firm)

“Although the “independent” component of the committee is not in line with the Code of conduct’s recommendations, this is not considered to be an obstacle to objective, balanced assessment of the activities performed by the company’s management and their subsequent remuneration, in view of the clear separation of roles and duties between the Management Board and Supervisory Board, the committee being formed from among the members of the latter”. (Italian firm)

Remuneration policy

Remuneration policy statement

Most firms present a policy statement as part of the remuneration report / annual report / notes to the financial statements / corporate governance report

Major differences in the extent of presentation of the remuneration policy between firms
e.g. between the UK standard and standards applied by other firms

A forward-looking statement: low degree of conformity

Compliant: Dutch and UK firms and to certain extent Danish firms; rest are not compliant

Terms of contracts

Low degree of conformity across Continental European firms

Duration of contracts, notice periods: information dispersed in other parts of the annual report

Termination payments:

Information provided by most UK, Swedish and Norwegian firms

Low disclosure: Ireland, Denmark, Greece, Austria, Italy, Belgium

Remuneration policy (cont.)

Preparatory and decision making process

Continental Europe: insufficient and dispersed information

External consultant: disclosed by UK, Swiss and Dutch firms; seldom by rest

Information fixed and variable remuneration

Not satisfactory given the importance of this provision: degree of compliance around 50%

Explanation of the relative importance of the non-variable and variable components

- provided by UK, Dutch and Swedish firms
- low degree elsewhere

Performance criteria:

- best disclosure UK and Dutch firms
- average: French and German firms
- low levels at the rest of the firms

Individual disclosure

Individual remuneration of executive and non-executive directors

Too many firms (approx. 25%) still do not comply with the requirement for disclosing both executive and non-executive individual remuneration

E.g. explanations for non-compliance

“Legal requirements are complied with and data is not broken down in order to respect the directors’ privacy”. (Spanish firm)

“The disclosure of individual directors’ salaries could be a potential source of conflict in cases of differences in remuneration, even if such differences are justified on the basis of different roles performed” (Portuguese firm)

“There are differences in the individual remuneration paid to directors and there would be no value added by listing these divergent amounts in a separate table. Moreover, given the specific composition of the Board of Directors, providing this information in such a table is not considered appropriate for privacy reasons”. (Belgian firm)

Individual disclosure (cont.)

Individual information share-incentive schemes

Wide differentiation between firms from various countries and within countries

➤ Details are disclosed in part

e.g. only granted / only exercised / only unexercised share options

➤ Aggregate disclosure instead of individual disclosure

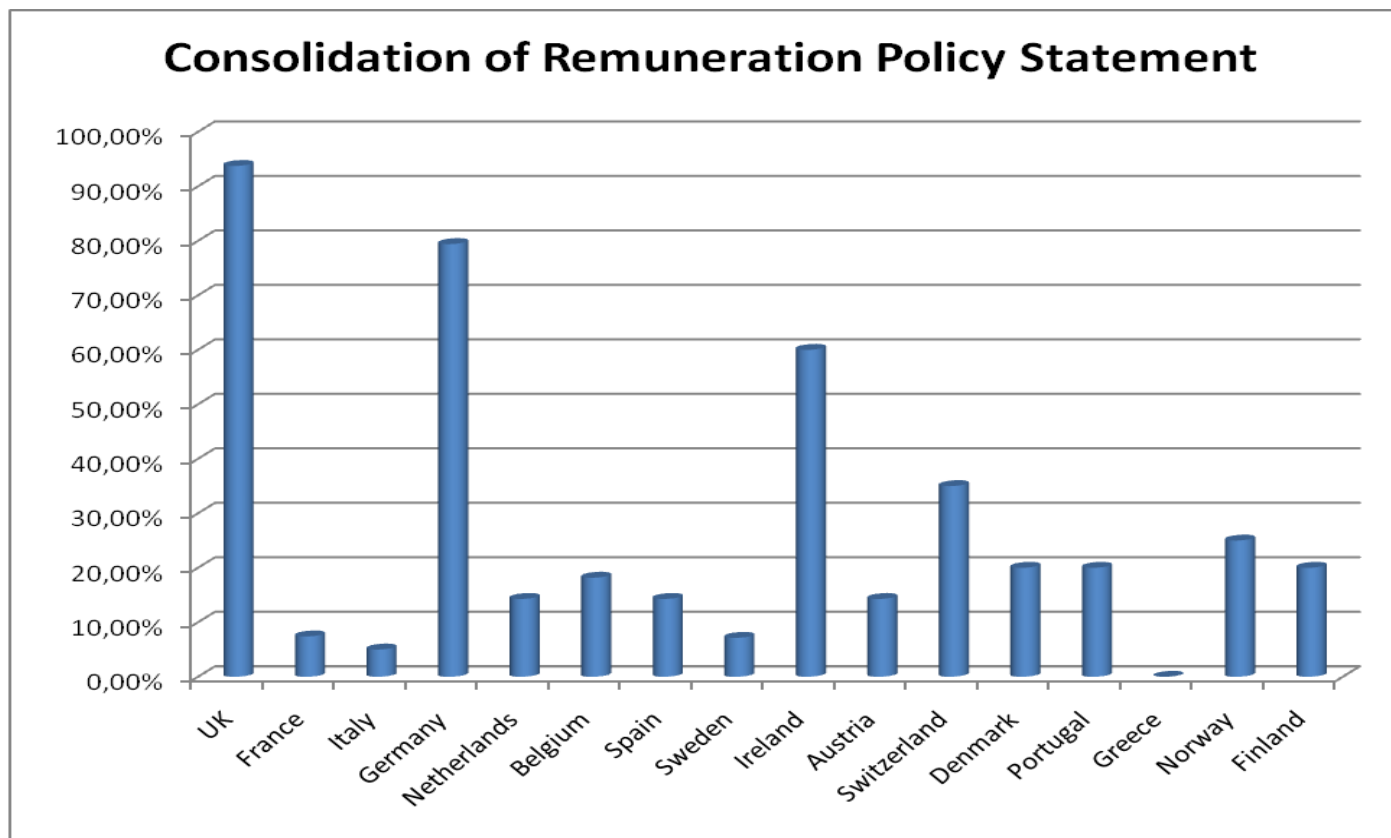
UK, Dutch and Irish firms: highest degrees of conformity

Firms from Portugal, Greece, Sweden, Switzerland: lowest degree of conformity

Consolidation of the remuneration policy

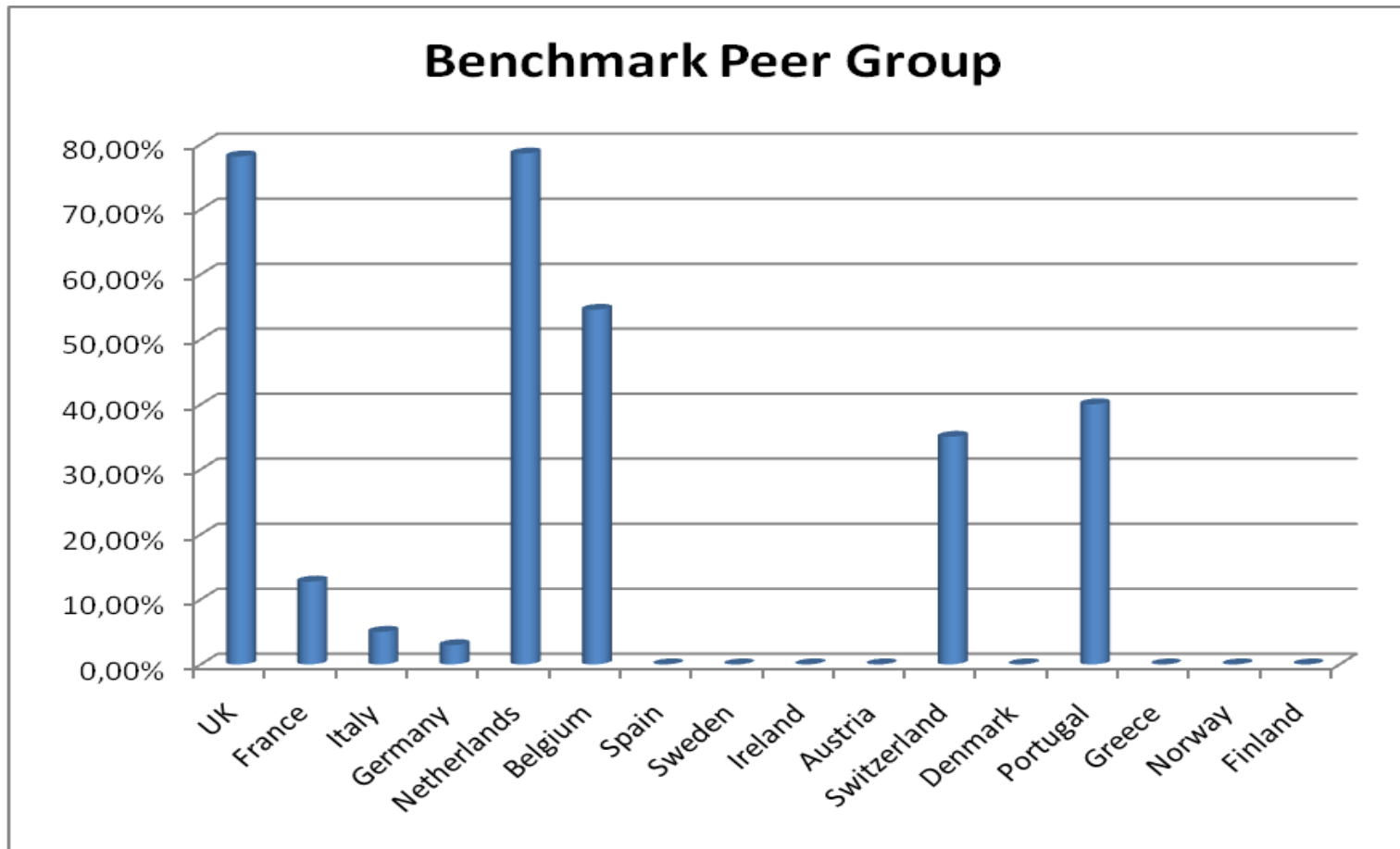
Continental Europe: elements of the remuneration policy are scattered throughout the annual report

- “A clear and comprehensive overview of the company’s remuneration” requirement has not been achieved
- Impediments on governance controls and on the assessment of the remuneration systems



Benchmark disclosure: industry, index, comparator group

- Acts as reference for the remuneration levels
- Not limited to national listed companies
- To be reviewed on a periodic basis



Differences in national regulations: Remuneration Committee

Differences:

- Existence
- Composition
- Chairing

UK Combined Code

- Creation of a separate Remuneration Committee formed entirely of non-executive, independent directors
- Chairman of the Board may be a member of, but may not chair, the Remuneration Committee

Germany Cromme Code

- No specific requirements for a Remuneration Committee
- German firms have the HR Committee handling directors' remuneration

Most other European Corporate Governance Codes

Creation of separate Remuneration Committees made up of all non-executive

- *majority* independent directors, *or*
- *sufficient number* of independent directors

Differences in national regulations: Severance Pay

Regulations not existent in all countries

UK

- Payment in Lieu of Notice; notice periods should be set at one year or less.

France

- Payment may not exceed 2 years' compensation
- Conditional upon the achievement of conditions linked to the performance of the beneficiary
- Performance criteria is submitted for approval to the AGM

Germany

- Payment should not exceed the value of 2 years' compensation
- In the event of premature termination, it should not exceed 150% of the severance payment cap

The Netherlands, Belgium

- Payment may not exceed one year's salary

Differences in national regulations: Say on Pay

Separate vote on:

- Remuneration principles / policy / Remuneration Report
 - Ex ante
 - Ex post

 - Binding
 - Advisory

UK: ex-post advisory vote on the Remuneration Report

Spain: ex-post advisory vote on the remuneration policy / report

The Netherlands, Sweden: ex-ante vote on the remuneration principles

Some **Swiss** firms adopted an advisory vote (Credit Suisse Group, Nestle SA and UBS)

Some firms in **Denmark** also adopt a binding vote on their remuneration

Conclusions

Insufficient application of Commission Recommendations

- Firms follow national regulation (public regulation and corporate governance codes) rather than Community regulation
- At country level: no full compliance with corporate governance guidelines
- National regulations have not transposed Commission's Recommendations in full
- Public regulation: transposition at lower levels comparing with the codes of corporate governance

Lack of harmonisation in disclosure

- Among firms located in various countries: due to differences in national regulations
- Among firms within countries: due to lax regulations
- In countries where the overall degree of conformity is higher, we observe less differences in the level of disclosure between firms

Importance of disclosure

- Control of the remuneration process and levels
- Harmonisation within countries and across Europe
- Accountability in relation with shareholders and other stakeholders
- Sustainability through maintaining balanced pay and link with firm performance

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