

**STANDARDISED
FRAMEWORK**
The revised
SRD addresses
remuneration
reporting and
shareholder
votes in Europe

REMUNERATION AND THE SHAREHOLDER RIGHTS DIRECTIVE

The impact of the European SRD II on companies' AGM remuneration votes will vary widely across Europe

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The transposition of the revised Shareholder Rights Directive into the national legislation of EU member states is expected to bring about a standardised framework in a number of areas, ranging from executive remuneration to related party transactions across Europe.

When it comes to executive remuneration, the revised EU Shareholder Rights Directive is aimed at encouraging a

higher standardised level of disclosure and greater accountability over directors' pay.

Once the requirements are implemented via member states' national legislation, minimum standards of shareholder say-on-pay will be implemented across the continent. In particular, the revised Shareholder Rights Directive provides that shareholders will be entitled to express their views through two different votes: a forward-looking vote on a company's remuneration policy, which lays down the framework for the award of remuneration to directors, and a retrospective vote on the remuneration report describing the

remuneration that has been granted to directors in the past year.

A number of EU member states had already put into place national regulations covering executive remuneration before the revised Shareholder Rights Directive was rolled out. Some of these overlap with the Directive, specifically the UK's three-year binding vote on remuneration policy, which sits alongside its long-standing annual advisory vote on remuneration policy. Elsewhere, notably in Germany and the Netherlands, states are still behind the times in terms of shareholder say on pay.

While in both of these laggard markets it's true that companies are to some extent required to obtain approval for their remuneration policy, a shareholder vote is usually only required when a change in the executive remuneration policy is envisaged. In particular, the current German Corporate Governance Kodex (under revision at the time of writing) provides that companies should hold a non-binding vote on remuneration policy at regular intervals or in cases where there has been a notable change. In the Netherlands, legislation only requires companies to put executive remuneration to a vote if there has been a material change in the policy. As a consequence, a discrete number of companies have not had a shareholder vote on executive remuneration for many years.

The general consensus is therefore that, especially in Germany and the Netherlands, national law implementing the revised Shareholder Rights Directive will require significant adjustments on the part of companies, as investors – who are accustomed to largely ignoring executive remuneration practices when no vote is involved – will 'discover' practices that they have long stopped tolerating in other markets where all companies already put their remuneration up for some sort of annual vote.

A pan-European regulatory framework

Pursuant to the provisions of the revised Shareholder Rights Directive, the vote on a company's remuneration policy can be either advisory or binding, depending on the member state's implementation of the directive requirement. A remuneration policy will need to be submitted to a shareholder vote at least every four years and, in any case, after any material change is made to it.

The remuneration policy will need to include, among other things, a description of all the components of fixed and variable remuneration, including bonuses and other benefits, which may be awarded to directors while also indicating their relative portion in a clear and understandable way.

Where a company awards variable remuneration, the remuneration policy shall set clear, comprehensive and varied criteria for such an award. If the award is share-based, the policy should also specify the vesting periods and, where applicable, the retention periods of shares after vesting. The company should indicate the financial and non-financial performance criteria, including, where appropriate, criteria relating to corporate social responsibility, and explain how they contribute to the overall business strategy and the methods to be applied to determine to what extent the performance criteria have been fulfilled. The policy should specify information on any deferral periods and on the possibility for the company to reclaim variable remuneration.

Further, the policy should contain information relating to the duration of contracts or arrangements with directors and the applicable notice periods, the main characteristics of supplementary pension or early retirement schemes, and the terms of the termination and payments linked to termination.

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The remuneration policy should explain the decision-making process followed for its determination, review and implementation, including measures to avoid or manage conflicts of interests and, where applicable, the role of the remuneration committee or other committees concerned. Where the policy is revised, it should describe and explain all significant changes and how it takes into account the votes.

As for the remuneration report, this shall include a comprehensive overview of remuneration (including all benefits in whatever form) awarded or due during the most recent year to each individual director.

The report shall also include the total remuneration of each individual director split into component parts (fixed and variable, and their relative proportion); information on the application of the

performance criteria; the annual change in remuneration in relation to the performance of the company and the change of employee remuneration over the last five financial years; remuneration deriving from undertaking within the same group of companies; the number of equity instruments granted or offered and the main conditions for their exercise; information on applicable claw-back provisions; and, lastly, information on any deviation from the implementation of the remuneration policy.

The European Commission has run a consultation on guidelines that are aimed at harmonising companies' annual disclosure for directors' remuneration. The consultation ended on 21 March 2019 but no indication of when a final draft of the guidelines will be published has been provided by the European Commission yet.



Germany

Currently, in Germany there is no mandatory requirement for annual shareholder approval on executive compensation. As stated previously, national regulation provides that shareholders may only vote on the remuneration system on a regular basis or where a notable change is implemented. The draft law for the implementation of the revised Shareholder Rights Directive is expected to bring about a number of notable changes.

In compliance with the German corporate law and governance structure, the draft implementing law (published on 11 October 2018) sets forth different rules for the remuneration of the management board and that of supervisory board members. According to the provisions of the draft implementing law, the supervisory board members' remuneration is to be determined by the shareholders at the AGM while the remuneration of the management board members is to be determined by the supervisory board in compliance with the policy which shall be submitted to a shareholder advisory vote once every four years.

As per the remuneration report, shareholders will be entitled to express an advisory vote every year and the draft implementing law provides that the supervisory board and the management board are jointly responsible for its drafting. It is currently envisaged that the remuneration report must contain retrospective information on the remuneration of both the supervisory members and management board members individually as well as information regarding the ratio of the average remuneration of directors compared to that of employees over a five year period. »

» Looking at current practice in Germany, it is notable that from 2010 to 2019, fewer than 100 votes on remuneration were undertaken in the DAX 30 index. Germany's situation as a latecomer in terms of giving shareholders a say with regard to the remuneration of directors is even more striking when we consider that in the 2019 AGM season only four DAX 30 companies submitted a remuneration system to their shareholders for a vote.

Some investors have argued that a gradual introduction of voluntary voting over remuneration matters would have helped to smooth the transition towards a more

Among the most notable features of the draft implementing law, is that it requires there not only that the vote on the remuneration policy be binding but that the remuneration must be adopted with a qualified majority of 75 per cent of the votes cast (unless otherwise provided by the articles of association). Such a high threshold for approval of the remuneration policy is likely to set Dutch companies on a learning curve to implement international best practice standards of remuneration to ensure their policies are approved with very comfortable majorities in the years to come.

an advisory retrospective vote on the remuneration awarded to individual directors is put forward as a stand-alone item at each AGM. As provided for in the revised Shareholder Rights Directive, it is envisaged that the remuneration report includes information about the total amount of remuneration split down to component parts; that the compliance of the actual remuneration within the framework set out by the policy approved by shareholders; the annual changes in remuneration compared with the company performance; and the development of employees' pay as well as information on any recovery provisions and deviations from the policy.

Conclusion

As member states implement the provisions set forth in the revised Shareholder Rights Directive for remuneration of executives, best practice for remuneration of executives becomes more and more institutionalised.

Moreover, since the introduction of the first annual remuneration votes (many major European markets had already introduced some form of annual remuneration votes: 2002 in the UK, 2010 in Spain, 2011 in Italy and 2013 in France and Switzerland), the demands of proxy advisors and institutional investors have steadily increased, both in terms of transparency and best practices, to which the companies in these markets have had to respond with significant improvements.

While France was granted a grace period during the first year of introduction of the new remuneration votes (in 2014

TRANSPARENCY FOR INSTITUTIONAL INVESTORS

German and Dutch companies will confront unseen challenges on their remuneration votes in 2020

developed shareholder franchise on remuneration of directors. As things stand, it is now clear that German companies will potentially be in for a rude awakening when shareholders are given a vote on their pay unless they swiftly get up to date with international standards of executive remuneration prior to the next AGM season.



Netherlands

In the Netherlands, national law implementing the provisions of the revised Shareholder Rights Directive is currently going through parliament. At the time of writing, the current draft implementing law provides that a binding shareholder vote shall be put forward at least every four years and this provision will be applicable both to the remuneration policy of the management board members and that of the supervisory board members (or to non-executive directors where the company has a unitary board structure).

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Furthermore, a greater involvement of the work councils is also envisaged. In particular, it is provided that, before a remuneration policy is put on the agenda for a shareholder vote, the work councils will have the right to provide their advice on the remuneration arrangements set out in the policy and that any deviation from the work councils' advice will need to be addressed. In addition, where the supervisory board of a company is entrusted with setting up the remuneration policy of the management board members and such supervisory board has a remuneration committee, the work councils' representative shall be part of the committee.

Lastly, it is envisaged that the policy must include a statement highlighting how the same policy is aligned with the company's values and identity as well as its mission.

The draft implementing law provides that

remuneration resolutions garnered an average of 92 per cent across the board), this seems less likely to happen for Germany and the Netherlands – the two most prominent markets still lagging behind in terms of executive remuneration votes may have to swiftly adapt to the new reality.

As both the proxy advisors' and investor-specific guidelines have become stricter and stricter on remuneration, German and Dutch companies will be forced to prepare for unseen challenges from investors and proxy advisors. The two markets will need to come to terms with the new requirements, not just through national implementation of the revised Shareholder Rights Directive but also by the investor community and its own sophisticated and ever-developing approach to executive remuneration. 🌐