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COMMISSION STAFF WORKING DOCUMENT

**Report on the application by Member States of the EU of the Commission
Recommendation on directors' remuneration**

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1. OBJECTIVE OF THE REPORT

Directors' remuneration matters a lot for a company. The level of managers' pay may have a significant impact on whether the company can recruit and retain directors having the qualities required to run the company efficiently.

Executives' pay has given rise to much debate recently and the question of the link between remuneration and performance is being raised now and again. Many agree with extraordinary pay when it is associated with extraordinary performance and shareholders get value for their investment. However, the payment of lucrative severance packages to managers who are perceived to have underperformed has attracted much criticism. The blame is often put on the failure of the "gatekeepers", i.e. (supervisory) boards whose role is to control the management.

Remuneration is one of the main areas of potential conflict of interests for executive directors. It also is a matter on which shareholders should be duly informed and due account taken of their interests. Remuneration systems, therefore, should be transparent and subject to appropriate governance controls. Transparency and control builds sustained investor confidence and contributes to business efficiency and market stability. This prompted the Commission to adopt a Recommendation on directors' remuneration¹ in 2004.

Executive remuneration also emerged as a prominent feature in many of the corporate fraud scandals at the turn of the century². These scandals revealed that some packages had been awarded without transparency or control despite the high cost for companies and their shareholders.

It was therefore necessary to strengthen control over the management as regards remuneration and to improve transparency on directors' pay in order to restore investor confidence in EU companies and securities markets. Moreover, greater transparency and control was expected to align remuneration with management performance, avoid excesses and consequently enhance efficiency and competitiveness.

The Recommendation on directors' remuneration provides for high standards of disclosure on directors' pay and recommends a greater involvement of shareholders in the decisions relating to remuneration. The Recommendation should be considered in conjunction with the

¹ Recommendation on fostering an appropriate regime for the remuneration of directors of listed companies

² In Parmalat, corporate funds have been transferred to the family members of the chief executive officer, and used as "pocket money". At Vivendi, a € 21 million severance package caused outrage. Skandia is reported to have paid an equivalent of \$ 79 million in bonuses that had not been approved by the board, nor disclosed to the market.

Commission's Recommendation on the role of non executive directors and board committees³, as non executive independent directors and the remuneration committee have an important role to play with regard to pay issues.

The objective of this report is to evaluate whether Member States have put in place the necessary framework in order to give effect to the main principles of the Recommendation on directors' remuneration. The Commission has issued another report analysing the endorsement of the Recommendation on independent directors (reference to be included). Issues related to the remuneration committee are addressed in that report.

Member States were invited to take the necessary measures to promote the application of the Commission Recommendation by 30 June 2006 either through legislation or through best practice rules based on the "comply or explain" principle.

"Comply or explain" gives flexibility to companies. Some companies may find that a certain recommendation is ill suited to their specific characteristics and/or compliance with this standard would be excessively burdensome or difficult. These companies are not required to comply with this specific principle as long as they disclose these deviations and provide an explanation to the market

The tables annexed to this report indicate to what extent a Member State has followed the requirements of the recommendation.

This report is based on the replies of Member States to a Commission questionnaire as well as on the examination of national corporate governance codes of these Member States. 21 Member States are covered in the report⁴. Any reference to Member States relates exclusively to those which have provided the Commission with information.

2. MAIN FINDINGS OF THE EVALUATION

A large majority of Member States have introduced high disclosure standards with regard to the remuneration of individual executives. A significant number of Member States have made such disclosure compulsory, thus going beyond the Recommendation's standards. Progress in this field is most welcome. Directors' pay is often regarded as the most visible reflection of the shareholders' or boards' ability to monitor management. Consequently, transparency on pay in itself may contribute to a move towards better control and higher efficiency.

Regrettably, the recommendation on disclosure of the remuneration policy has not met with a high level of acceptance in Member States. Furthermore, only a disappointingly low number of Member States considered it necessary to recommend that shareholders vote on the remuneration criteria of the board/management board. Although shareholders usually have a say in determining the remuneration of the (supervisory) board, only few Member States have encouraged companies to involve shareholders to a greater extent in the decision on the remuneration policy of the management board/executive management, even if only on an advisory basis.

3 Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, O.J. L 52, 25.02.2005, p. 51

4 Bulgaria, Cyprus, the Czech Republic, Portugal, Romania and Spain are not covered.

Most Member States, however, have recommended or imposed shareholder approval of share-based incentive schemes. This is a very positive development as stronger shareholder checks are likely to reduce the risks inherent to such schemes.

On the whole, the level of application of the recommended transparency requirements on the remuneration policy and individual directors' pay appears to be relatively high, even though the Commission would have expected more progress as regards those recommendations which aim at eliminating conflicts of interests (see report on the application of the recommendation on independent directors) and give shareholders more power in the decisions on the remuneration policy.

It is likely that a higher level of transparency will induce investors to be more active in companies' affairs and claim greater involvement in remuneration matters. It may also contribute to the improvement of the standing of business and reinforce investors' trust in corporate leaders. The Commission intends to closely monitor market developments before deciding whether any further measure would be necessary in this field.

3. MAIN PRINCIPLES OF THE RECOMMENDATION

The recommendation invites Member States to adopt measures in four areas.

(i) Disclosure of remuneration policy

It is recommended that shareholders be provided with a clear and comprehensive overview of the company's remuneration policy⁵. Disclosure of information on the remuneration policy allows shareholders and investors to assess the main parameters and rationale for the different components of the remuneration package, the linkage between remuneration and performance, etc. Such disclosure aims to strengthen the company's accountability to shareholders.

(ii) Shareholders' vote on remuneration policy

With a view to increasing shareholder participation in the decisions on directors' pay, the Recommendation proposes that the remuneration policy should be put on the agenda of the shareholders' general meeting. It should also be subject to a vote which may be either binding or advisory. This recommendation is based on the assumption that the debate and vote at the shareholder's meeting is the only efficient way to ensure that shareholders can express their views and exert a real influence on the company's remuneration policy.

(iii) Disclosure of the remuneration of individual directors

Transparency on individual remuneration allows shareholders to appreciate remuneration in light of the performance of the company. To this end, the recommendation supports the line by line disclosure of executives' remuneration packages and specifies the details of such disclosure.⁶

5 All listed companies should release a statement of their policy on directors' remuneration for the following year. It should include information on the breakdown of fixed and variable remuneration, on performance criteria and on the parameters for annual bonus schemes or non-cash benefits. It should also explain the company's contract policy.

6 Such as shares or rights to share options granted to them, contribution to supplementary pension schemes, loans, advances or guarantees to each director, etc.

(iv) Prior shareholder approval of share and share option schemes

Share-based remuneration schemes aim at better aligning the interests of directors and shareholders.⁷ However, remuneration based on such schemes does not fully eliminate conflicts of interests between the management and shareholders and may even have some negative side effects. Such schemes may increase the pressure for directors to produce short term positive results.⁸ In addition, share based schemes lead to a shift of monetary benefits and control rights away from shareholders to executive directors. As the share price is linked to the reported financial performance of the company, directors may be tempted to overstate the performance of the company. In order to address these problems, it is recommended that shareholders approve such incentive schemes in advance.

4. ASSESSMENT OF THE IMPLEMENTATION OF THE RECOMMENDATION

The report on the application of the Recommendation on independent directors gives an overview of the corporate governance framework in individual Member States. The information provided and statements made in that report, which are not reiterated here, may also be relevant in this context. It has to be noted however, that unlike the Recommendation on independent directors, about half of Member States reviewed have chosen to introduce some of the provision of the Recommendation on remuneration as legally binding rules rather than best practice recommendations. The tables in the annex indicate the legal nature of the relevant implementing provision.

4.1. Disclosure of remuneration policy

In some Member States, shareholders have wide decision making powers in remuneration issues. The general meeting has, by law, the sole competence to decide on the remuneration of directors in a number of countries. This may involve decisions on the remuneration packages of individual members or approval of the total amount of remuneration. In countries where companies have dual boards, shareholders are generally responsible for determining the remuneration of supervisory board members only. In some Member States, however, the remuneration of (some of) the company's directors is decided by a corporate body which is different from the shareholders' meeting.

As the remuneration policy statement allows shareholders and potential investors to have a better understanding on the principles of remuneration and facilitates decision regarding the remuneration of individual directors, disclosure on the remuneration policy remains valid also in those companies where shareholders have a say in remuneration issues. Furthermore, it provides shareholders with a clear picture on the parameters of remuneration of those managers whose remuneration is decided by others.

Table 1 in the Annex shows that the recommendation on disclosure of the remuneration policy is followed by about 60% of the Member States, although half of these Member States endorse it only in part.

7 As a result of such schemes, the remuneration of executive directors to a certain extent is dependent on the share price.

8 According to the time contingency component included in their remuneration terms

In some countries with dual board structures, disclosure of the policy regarding the remuneration of supervisory board members is not recommended⁹ or such disclosure is recommended without an obligation to "comply or explain".¹⁰

In some of those Member States which recommend disclosure of remuneration policy, the contents of this disclosure is not specified.

4.2. Shareholders' vote on the remuneration policy

This recommendation does not seem to be appropriately implemented in the majority of Member States.

About a third of the Member States have such a recommendation in place.¹¹ In some of these Member States, the remuneration policy is subject to a separate vote.¹² In others, the remuneration policy is part of the annual report and a separate vote is not recommended on the remuneration policy in addition to the approval of the annual report.¹³

As referred to above, in several of the other Member States, the general meeting is involved in the preparation of, or decision on, the remuneration of (some of the) directors, but there is no recommendation or binding rule requiring a separate vote on the remuneration policy.¹⁴

4.3. Disclosure of individual board members' remuneration

More than two thirds of the Member States follow the recommendation on the disclosure of individual board members' remuneration and recommend or require the disclosure of the remuneration of both executive and non-executive (supervisory) board members.¹⁵

In the majority of these Member States, disclosure is required by law on a mandatory basis. German law allows for a derogation from this rule if the general meeting so decides by a 75% majority.

9 Austria

10 Germany

11 France, Ireland, Hungary, Lithuania, Malta, the Netherlands, Sweden, and the UK. In Slovenia, it is recommended that the remuneration policy regarding supervisory board members be decided by the general meeting, but there is no requirement to disclose.

12 E.g. the UK, Lithuania

13 E. g. France, Ireland

14 In Denmark, the policy of remuneration for all board members should be mentioned by the Chairman at the general meeting, however the general meeting decides only on the actual remuneration to be paid to the supervisory board.

15 Germany, Denmark, Estonia, Finland, France, Ireland, Italy, Lithuania, Malta, the Netherlands, Poland, Sweden, Slovenia, Slovakia and UK

Disclosure is usually required on an individual basis, although a few countries only recommend the disclosure, as one global sum, of the total amount of directors' remuneration.¹⁶

As far as the contents of the disclosure are concerned, most Member States seem to follow the basic requirements of the Recommendation.¹⁷

4.4. Prior shareholder approval of share-based remuneration schemes

The recommendation providing that share-based remuneration schemes shall be subject to prior shareholder approval seems to have been endorsed by a majority of Member States. A considerable number of Member States impose such a rule on a mandatory basis.

In some Member States, however, shareholder authorisation is required for incentive schemes remunerating certain directors only.¹⁸ In others, such an approval is limited to certain types of share-based remuneration.¹⁹

The details of the recommendation related to the contents of the shareholder approval (e.g. maximum number of shares, exercise-term of option schemes) have not been specified in several Member States.

5. CONCLUSION

On the whole, the recommended transparency requirements on the remuneration policy and individual directors' pay appears to be applied in a majority of Member States. The same cannot be said of those recommendations which aim at eliminating conflicts of interests (see report on the endorsement of the recommendation on independent directors) and give shareholders more influence over pay.

As corporate governance reforms are still ongoing in a number of Member States, the Commission will continue to monitor regulatory developments as well as examine the provisions or recommendations of those countries which have not taken part in this evaluation.

16 In Belgium, the remuneration of the CEO and non-executive directors is to be disclosed on an individual basis, whereas such information is to be provided on a global basis only regarding other executives. In Greece and Luxemburg, only the total remuneration of all the directors is to be disclosed.

17 In a few Member States (Germany and Estonia), however, the rules and recommendations are less explicit as to the contents of the disclosure regarding supervisory directors. The Danish corporate governance code does not recommend that the disclosure on individual directors' remuneration should be detailed, except for certain benefits, such as share-based remuneration.

18 Supervisory board members in Denmark and supervisory board or the board of directors in Slovenia. Schemes set up for the benefit of the management board are therefore not subject to shareholder approval in these countries. In France, the general meeting approves share options for the benefit of the management only.

19 In some other Member States, only share-based remuneration involving new share issues, share options or any other new share acquisition right (Luxemburg, Sweden) is to be approved by the general meeting. In France, the general meeting decides on share options only. Furthermore, in a few Member States, shareholders are only invited to approve long-term share-based remuneration schemes only.

Furthermore, remuneration is a field where some companies have shown strong reluctance to disclose information despite the recommendation on a "comply or explain" basis.

In close association with the European Corporate Governance Forum, the Commission intends to continue monitoring the way Member States have implemented the Recommendation and the extent to which the principles of the Recommendation are adhered to in practice. This will help evaluate whether or not the expected effects of the recommendation will materialise. Based on this further evaluation, the Commission will assess whether there is a need for any additional measures in this field.

Table 1

Disclosure on remuneration policy		
Member State	Disclosure on remuneration policy	Nature of the rule
AT	Partly, the remuneration policy statement covers the main elements of the remuneration policy of management boards only.	C
BE	Y, there is a general recommendation on disclosure of remuneration policy, but there are no details on the contents of such a statement.	C
DE	Partly, as regards <u>management board members</u> , the corporate governance code provides that the chairman of the supervisory board shall outline the salient points of the compensation system to the GM. Disclosure should be made in a compensation report which describes the compensation system for management board members. As regards <u>supervisory board members</u> , it is recommended that the <i>Lagebericht</i> of the annual report reports on the bases of the remuneration system.	C R
DK	Y	C (L expected Spring 2007)
EE	N	
EL	N	-
FI	Y (partly), as regards the managing director and other executives, it is recommended that the company publish the criteria concerning the compensation system. The terms of contract of the managing director and the full time board chairman is recommended to be disclosed. Other board members do not seem to be covered by this obligation. As to supervisory board members it is recommended that the company informs shareholders about the criteria of their compensation.	C
FR	Y, French law requires that the fix and variable elements of the remuneration of directors, the underlying criteria of their calculation and engagements made by the company for the benefit of directors are described in the annual report.	L
HU	N	
IE	Y	L
IT	N	L
LV	Y, the publication of remuneration policy is recommended but there is only general wording on its contents.	C
LT	Y	C

LU	Y	C
MT	Y	C
NL	Y	C
PL	N	
SE	Y	L
SI	N (partly), the remuneration policy regarding supervisory board members should be decided on by the GM, but there is no recommendation to disclose this remuneration policy nor the one related to management board members.	C
SK	N, it is referred to in the explanations of the CG Code that the annual report should contain a statement on the remuneration policy. There is no reference to its contents.	R
UK	Y, mandatory policy statement as part of the Directors' Remuneration Report, including performance criteria for share schemes and variable/non variable elements on an individual basis	C

Evaluation criteria: Y: it is required or recommended on a “comply or explain” basis that the company discloses information on its remuneration policy and at least some of the requirements regarding the content of the disclosure are specified. These content requirements are the following: (1) importance of the variable and non-variable components, (2) performance criteria, (3) rationale for a bonus scheme, (4) main characteristics of pension schemes and (5) terms of contract of executive directors. If the recommendation regarding the contents of the disclosure or the personal scope of the requirement is not followed, this is specified in the table.

L: mandatory legislative provision

C: "comply or explain" recommendation

R: recommendation without "comply or explain"

Table 2

GM vote on remuneration policy		
Member State	Endorsement of recommendation	Nature of the rule
AT	N	
BE	N, fixing the remuneration of directors is the exclusive power of the GM, which cannot be delegated to the board. However, the GM can leave it to the board to allocate the total amount among directors. Neither the allocation nor the remuneration policy must be submitted to the GM.	
DE	N, in Germany the GM decides on the remuneration of supervisory board members. However there does not seem to be a specific requirement for the GM to approve the remuneration policy of supervisory board members. The remuneration policy of management board members is not subject to a specific approval by the GM.	L
DK	1) It is recommended that the company's remuneration policy be mentioned in the statement given by the chairman at the company's GM. 2) Only the remuneration of the supervisory board is to be presented for adoption at the general meeting as part of the approval of the annual account. There is no specific vote on the remuneration policy.	1) C (L expected Spring 2007) 2) L
EE	N	
EL	N (the GM decides on the remuneration of the board of directors, which, in turn, decides on the remuneration of corporate managers and other employees and the general remuneration policy of the company)	L
FI	According to the general principles of the Finnish company law, the remuneration of a member of the board is determined by the same organ that has elected the board. However, there does not seem to be detailed requirements in place as regards the approval of the principles of the remuneration policy. The compensation of the managing director and other executives is decided by the board.	
FR	Y, however the vote relates to the annual report in general.	L
HU	Partly, the GM decides on the guidelines for long-term pay and incentive schemes for executive officers, supervisory board members and executive employees.	L
IE	Y, however the vote relates to the annual report in general, not to the remuneration policy separately. The update of the listing rules is currently being considered to provide that the remuneration policy should be submitted to vote.	L
IT	In the traditional model and in the one-tier model, GM is vested with the power to approve the remuneration of board members. In the two-tier model, the supervisory board determines the remuneration of management, unless the articles of association assign such power to the GM, and the GM decides on the remuneration of supervisory board members. However, there is no specific vote on the remuneration criteria.	L

LV	N	
LT	Y, either mandatory or advisory	C
LU	N	
MT	Y, shareholders are recommended to approve the aggregate remuneration payable and the criteria applied to establish the remuneration of directors	C
NL	Y	L
PL	N	
SE	Y, the GM decides on the remuneration policy and the remuneration of each member of the board of directors.	L
SI	Partly, the GM decides on the amount and method of determining individual remunerations of supervisory board members or members of the board of directors. Supervisory board decides on the remuneration of the management board. Profit-sharing should be allowed in the articles of association and be confirmed by the GM.	L general C
SK	N, the GM may decide on the remuneration of both the members of the management and supervisory boards if such power is set out in the articles of association, etc. However there is no obligation or C/E recommendation to do so. There is no recommendation for the GM to approve the remuneration policy. It is planned that in the revised version of the corporate governance code a recommendation on GM approval of the remuneration statement will be included.	L
UK	Y, the AGM must include a resolution approving the Directors' remuneration report	C

Table 3

1. Disclosure of remuneration of individual board members		
2. Details of publication		
Member State	Endorsement of recommendation	Nature of rule
AT	<p>1. N, it is recommended without comply or explain that fixed and performance related remuneration be disclosed for each individual member of the management board in the annual report. Austrian law requires disclosure of only the total remuneration of managers and supervisors on a mandatory basis.</p> <p>2. N</p>	1. R
BE	<p>1. Partly, only CEO and non-executive directors individually, other executives globally.</p> <p>2. Partly, details on an individual basis are required only regarding the CEO. As to the other executive managers, details are required on a global basis only.</p> <p>The main contractual terms of hiring and termination arrangements with executive managers as well as share based remuneration should be disclosed regarding the executive management.</p>	<p>1. C</p> <p>2. C</p>
DE	<p>1. Y</p> <p>However, both German Law and the corporate governance code allow derogation from this rule if the general meeting decides by a 75% majority that the individual remuneration should not be disclosed.</p> <p>2.Y</p> <p>However regarding supervisory board members, there is only a general recommendation as to the disclosure to be broken down according to forms of remuneration.</p>	<p>1. L and C</p> <p>2. L and C</p>
DK	<p>1. Y</p> <p>2. Partly. Remuneration and other benefits are not disclosed in details for individuals, but are disclosed in total. Certain benefits, such as share based remuneration are disclosed in details for individuals.</p>	<p>1. C</p> <p>2. C</p>
EE	<p>1. Y</p> <p>2. Y, more detail on remuneration of management</p>	<p>1. C</p> <p>2. C</p>
EL	<p>1. No, only the total remuneration of Board members is to be disclosed according to the provisions of IAS/IFRS in the interim and annual financial statements.</p>	1. L

	2. N (apart from the minimum requirements of the IAS/IFRS)	
FI	1. Y 2. Y	1. C 2. C
FR	1. Y 2. Y	1. L 2. L
HU	N	
IE	1. Y 2. Y	1. L 2. L
IT	1. Y 2. Y	1. L 2. L
LV	N	
LT	1. Y 2. Y	1. C 2. C
LU	1. N, there is no requirement to disclose information on an individual basis. The amount of the total remuneration paid to executive and non-executive directors as well as details on share options (the number of share options offered, exercised and unexercised during the financial year, change in conditions, etc) are to be disclosed on a global basis. 2. N	1. C
MT	1. Y 2. Y	1. C 2. C
NL	1. Y 2. Y, however as regards supervisory board members, the rules refer to the amount of remuneration, bonus and share-based remuneration only.	1. L 2. L and C
PL	1. Y 2. Y, except for pension schemes	1. L 2. L
SE	1. Y 2. Y	1. L
SI	1. Y 2. Y	1. L and C 2. L and C

SK	1. Y 2. N	1. C
UK	1. Y 2. Y	1. C 2. C

Evaluation criteria regarding details of disclosure:

Y: at least salary, bonuses, termination payment, share or share options and pension benefits are disclosed.

N: no details on disclosure

Table 4

Prior shareholder approval of share-based remuneration schemes		
Member State	Endorsement of recommendation	Nature of rule
AT	Y	L
BE	Y	C
DE	Y	L
DK	Partly, relates only to share-based schemes for supervisory board.	C, L expected Spring 2007
EE	Y	L for share option schemes for supervisory board members, C for management board members
EL	Y	
FI	Y	L
FR	Partly, the GM has the power to authorise the granting of options and to determine the main conditions of the granting process for the benefit of the management only.	L
HU	N	
IE	Y (long-term incentive schemes)	L
IT	Y	L
LV	Y	C
LT	Y	C
LU	Partly, only schemes providing for remuneration of directors and managers by new share issues, share options or any other new share acquisition right should be approved in advance by the GM	C
MT	N	
NL	Y	L
PL	Partly, only capital increase is to be decided on by the GM	L
SE	Partly, new issue of shares, warrants or convertible instruments to be approved by the GM	L
SI	Partly, the GM approves such schemes for members of the supervisory board or board of directors. As regards members of management board there is a requirement of notification to the GM only.	L

SK	Y, but approval is recommended regarding long-term schemes only and there are no details on the contents of the approval.	C
UK	Y	L