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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.4.2009
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COMMISSION RECOMMENDATION

**complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime
for the remuneration of directors of listed companies**

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COMMISSION RECOMMENDATION

complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies

(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the second indent of Article 211 thereof,

WHEREAS:

- (1) On 14 December 2004, the Commission adopted Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies¹ and on 15 February 2005 the Commission adopted Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board². The main objectives of those Recommendations are to ensure transparency of remuneration practices, shareholder control on the remuneration policy and individual remuneration through disclosure and the introduction of a mandatory or advisory vote on the remuneration statement and shareholder approval for share-based remuneration schemes, effective and independent non-executive supervision and at least an advisory role of the remuneration committee with regard to remuneration practices.
- (2) It follows from those Recommendations that the Commission should monitor the situation, including implementation and application of the principles included in those Recommendations, and assess the need for further measures. Moreover, experience over the last years, and more recently in relation to the financial crisis, has shown that remuneration structures have become increasingly complex, too focused on short term achievements and in some cases led to excessive remuneration, which was not justified by performance.
- (3) Whilst the form, structure and level of directors' remuneration continue to be matters primarily falling within the competence of companies, their shareholders and, where applicable, employee representatives, the Commission considers that there is a need for additional principles regarding the structure of directors' remuneration, as set out in a company's remuneration policy and the process of determining remuneration and control on that process.
- (4) This Recommendation is without prejudice to the rights, where applicable, of social partners in collective bargaining.
- (5) The existing regime for the remuneration of directors of listed companies should be strengthened by principles which are complementary to those contained in Recommendations 2004/913/EC and 2005/162/EC.

¹ OJ L 385, 29.12.2004, p. 55.

² OJ L 52, 25.2.2005, p. 51.

- (6) The structure of directors' remuneration should promote the long term sustainability of the company and ensure that remuneration is based on performance. Variable components of remuneration should therefore be linked to predetermined and measurable performance criteria, including criteria of a non-financial nature. Limits should be set on the variable components of remuneration. Significant variable components of remuneration should be deferred for a certain period, for example three to five years, subject to performance conditions. Further, companies should be able to reclaim variable components of remuneration that were paid on the basis of data, which proved to be manifestly misstated.
- (7) It is necessary to ensure that termination payments, so-called 'golden parachutes', are not a reward for failure and that the primary purpose of termination payments as a safety net in case of early termination of the contract is respected. To that purpose, termination payments should be limited to a certain amount or duration beforehand, which, in general, should not be more than two years annual remuneration (on the basis of only the non-variable component of the annual remuneration) and not be paid if the termination is due to inadequate performance or if a director leaves on his own account. This does not preclude termination payments in situations of early termination of the contract, due to changes in the strategy of the company or in merger and/or takeover situations.
- (8) Schemes under which directors are remunerated in shares, share options or any other right to acquire shares or be remunerated on the basis of share price movements should be better linked to performance and long term value creation of the company. Therefore, an appropriate vesting period should apply to shares, whereby vesting is made subject to performance conditions. Share options and rights to acquire shares or be remunerated on the basis of share price movements should be not be exercisable during an appropriate period and the right to exercise them should be made subject to performance conditions. In order to further prevent conflicts of interest of directors who hold shares in the company, these directors should be obliged to retain a part of their shares until the end of their mandate.
- (9) In order to facilitate the shareholders' assessment of the company's approach to remuneration and strengthen the company's accountability towards its shareholders, the remuneration statement should be clear and easily understandable. Moreover, further disclosure of information relating to the structure of remuneration is necessary.
- (10) In order to increase accountability, shareholders should be encouraged to attend general meetings and make considered use of their voting rights. In particular, institutional shareholders should take a leading role in the context of ensuring increased accountability of boards with regard to remuneration issues.
- (11) Remuneration committees, as referred to in Recommendation 2005/162/EC, fulfil an important role in designing a company's remuneration policy, preventing conflicts of interests and supervising the (managing) boards behaviour in the context of remuneration. To strengthen the role of those committees, at least one member thereof should have expertise in the field of remuneration.
- (12) Remuneration consultants may have conflicting interests, for instance when they advise the remuneration committee on remuneration practices and arrangements, and at the same time advise the company or the executive or managing director(s). It is appropriate for remuneration committees to exercise caution when hiring remuneration consultants in order to ensure that the same consultants do not advise the human

resources department of the company or executive or managing directors at the same time.

- (13) In view of the importance of the question of remuneration of directors and in order to enhance the effective application of the Community framework on directors' remuneration, the Commission intends to make extended use of different monitoring mechanisms, such as annual scoreboards and mutual evaluation by Member States. Moreover, the Commission intends to explore the possibilities of standardising disclosure of directors' remuneration policy.
- (14) The notification of measures by Member States in accordance with this Recommendation should include a clear timeframe for companies to adopt remuneration policies consistent with the principles set out in this Recommendation,

HEREBY RECOMMENDS:

SECTION I SCOPE AND DEFINITIONS

1. Scope
 - 1.1. The scope of section II of this Recommendation corresponds to that of Recommendation 2004/913/EC.

The scope of section III of this Recommendation corresponds to that of Recommendation 2005/162/EC.
 - 1.2. Member States should take all appropriate measures to ensure that listed companies, to which Recommendations 2004/913/EC and 2005/162/EC are applicable, have regard to this Recommendation.
2. Definitions in addition to those laid down in Recommendations 2004/913/EC and 2004/162/EC:
 - 2.1. 'Variable components of remuneration' means components of directors' remuneration entitlement which are awarded on the basis of performance criteria, including bonuses.
 - 2.2. 'Termination payments' means any payment linked to early termination of contracts for executive or managing directors, including payments related to the duration of a notice period or a non-competition clause included in the contract.

SECTION II
REMUNERATION POLICY
(SECTION II OF RECOMMENDATION 2004/913/EC)

3. Structure of the policy on directors' remuneration

3.1. Where the remuneration policy includes variable components of remuneration, companies should set limits on the variable component(s). The non-variable component of remuneration should be sufficient to allow the company to withhold variable components of remuneration when performance criteria are not met.

3.2. Award of variable components of remuneration should be subject to predetermined and measurable performance criteria.

Performance criteria should promote the long-term sustainability of the company and include non-financial criteria that are relevant to the company's long term value creation, such as compliance with applicable rules and procedures.

3.3. Where a variable component of remuneration is awarded, a major part of the variable component should be deferred for a minimum period of time. The part of the variable component subject to deferment should be determined in relation to the relative weight of the variable component compared to the non-variable component of remuneration.

3.4. Contractual arrangements with executive or managing directors should include provisions that permit the company to reclaim variable components of remuneration that were awarded on the basis of data which subsequently proved to be manifestly misstated.

3.5. Termination payments should not exceed a fixed amount or fixed number of years of annual remuneration, which should, in general, not be higher than two years of the non-variable component of remuneration or the equivalent thereof.

Termination payments should not be paid if the termination is due to inadequate performance.

4. Share-based remuneration

4.1. Shares should not vest for at least three years after their award.

Share options or any other right to acquire shares or to be remunerated on the basis of share price movements should not be exercisable for at least three years after their award.

4.2. Vesting of shares and the right to exercise share options or any other right to acquire shares or to be remunerated on the basis of share price movements, should be subject to predetermined and measurable performance criteria.

4.3. After vesting, directors should retain a number of shares, until the end of their mandate, subject to the need to finance any costs related to acquisition of the shares. The number of shares to be retained should be fixed, for example twice the value of total annual remuneration (the non-variable plus the variable components).

- 4.4. Remuneration of non-executive or supervisory directors should not include share options.
5. Disclosure of the policy on directors' remuneration
 - 5.1. The remuneration statement, mentioned in point 3.1 of Recommendation 2004/913/EC, should be clear and easily understandable.
 - 5.2. In addition to the information set out in point 3.3. of Recommendation 2004/913/EC, the remuneration statement should include the following:
 - (a) an explanation how the choice of performance criteria contributes to the long term interests of the company, in accordance with point 3.2. of this Recommendation;
 - (b) an explanation of the methods, applied in order to determine whether performance criteria have been fulfilled;
 - (c) sufficient information on deferment periods with regard to variable components of remuneration, as referred to in point 3.3. of this Recommendation;
 - (d) sufficient information on the policy regarding termination payments, as referred to in point 3.4. of this Recommendation;
 - (e) sufficient information with regard to vesting periods for share-based remuneration, as referred to in point 4.1. of this Recommendation;
 - (f) sufficient information on the policy regarding retention of shares after vesting, as referred to in point 4.3. of this Recommendation;
 - (g) sufficient information on the composition of peer groups of companies the remuneration policy of which has been examined in relation to the establishment of the remuneration policy of the company concerned.
6. Shareholders' vote
 - 6.1. Shareholders, in particular institutional shareholders, should be encouraged to attend general meetings where appropriate and make considered use of their votes regarding directors' remuneration, while taking into account the principles included in this Recommendation, Recommendation 2004/913/EC and Recommendation 2005/162/EC.

SECTION III

THE REMUNERATION COMMITTEE

(POINT 3 OF ANNEX I TO RECOMMENDATION 2005/162/EC)

7. Creation and composition
 - 7.1. At least one of the members of the remuneration committee should have knowledge of and experience in the field of remuneration policy.

8. Role
 - 8.1. The remuneration committee should periodically review the remuneration policy for executive or managing directors, including the policy regarding share-based remuneration, and its implementation.
9. Operation
 - 9.1. The remuneration committee should exercise independent judgement and integrity when exercising its functions.
 - 9.2. When using the services of a consultant with a view to obtaining information on market standards for remuneration systems, the remuneration committee should ensure that the consultant concerned does not at the same time advise the human resources department or executive or managing directors of the company concerned.
 - 9.3. In exercising its functions, the remuneration committee should ensure that remuneration of individual executive or managing directors is proportionate to the remuneration of other executive or managing directors and other staff members of the company.
 - 9.4. The remuneration committee should report on the exercise of its functions to the shareholders and be present at the annual general meeting for this purpose.

SECTION VI

FINAL PROVISIONS

10. Member States are invited to take the necessary measures to promote the application of this Recommendation by 31 December 2009.

In this respect, Member States are invited to organise national consultations with stakeholders on this Recommendation and to notify the Commission of measures taken in accordance with this Recommendation in order to allow the Commission to monitor closely the situation, and on this basis assess the need for further measures.

11. This Recommendation is addressed to the Member States.

Done at Brussels, 30.4.2009.

For the Commission
Siim KALLAS
Vice-President of the Commission