

New EU Provisions for Directors' Remuneration and for Policies in Financial Services

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Existing framework

2004 & 2005 Recommendations:

- Objectives : increased transparency and strengthening corporate governance checks over remuneration.
- 5 main lines of action:
 1. Disclosure of remuneration policy
 2. Shareholders' vote on remuneration policy
 3. Disclosure of the remuneration of individual directors
 4. Prior shareholder approval of share and share option schemes
 5. Creation on remuneration committees

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Developments at EU level

- Issues like level of Directors' pay, lack of transparency, possible conflicts of interest, taxation already on the table
- Since 2008 and financial services crisis, new issues:
 1. Excessive risk taking and short termism of remuneration structures in the financial sector
 2. Mismatch between pay and performance for directors' remuneration, in particular in cases of severance pay ("golden parachutes")
 3. Insufficient oversight over remuneration policy

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Developments at EU level(2)

- Commission Communication on 'Driving European Recovery' - 4th March 2009
- Commission Communication accompanying the two recommendations- 29th April 2009

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1. Directors' remuneration Recommendation.

- Scope remains the same as 2004 and 2005 Recommendations: i.e. listed companies.
- The existing policy of pay for performance through disclosure is built upon by focusing on certain aspects of 1) the structure of directors' remuneration and 2) the process of determining directors' remuneration.

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A. Structure of Directors' remuneration

- sets a limit (2 years maximum of fixed pay) on severance pay (golden parachutes) and provides for no severance pay in case of failure.
- requires a balance between fixed and variable pay and links the award of variable pay to predetermined and measurable performance criteria to strengthen linkage between performance and pay.
- provides for a balance between long and short term performance criteria, a deferment of variable directors' remuneration, a minimum vesting period for stock options and shares (at least three years); a minimum holding of part of shares until the end of employment. All these elements are to contribute to promote the long term sustainability of the company.
- allows companies to reclaim variable components of remuneration that were paid on the basis of data, which proved to be manifestly misstated ("claw back").

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B. Process of determining directors' remuneration

- extends disclosure requirements to cover new principles to improve shareholders' oversight of remuneration policies;
- calls on shareholders, in particular institutional investors to be more active;
- provides that non-executives should not receive share options as part of their remuneration to avoid conflict of interests;
- provides strengthening of the operation of the remuneration committee

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2. Recommendation on remuneration policies in the financial services sector

- **The objective**
 - General principle : remuneration policies which are consistent with and promote sound and effective risk management.
 - Specific principles on:
 - structure of pay
 - governance
 - disclosure
 - supervision

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2. Recommendation on remuneration policies in the financial services sector

• The scope

Recommendation applies to:

- “financial undertakings” i.e. all professional actors in the financial services industry, regardless of their legal status and size or whether they are listed or not;
- those categories of staff whose professional activities have an impact on the risk profile of the financial undertaking.

Recommendation does not apply to:

- fees and commissions received by intermediaries and external service providers in case of outsourced activities.

Proportionality principle:

- Member States should take into account the nature, the size and the specific scope of activities of the financial undertakings concerned.

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2. Recommendation on remuneration policy in the financial services sector

A. Structure

- appropriate balance between fixed and variable components;
- sufficiently high fixed component;
- variable component linked to performance with a deferred payment of a major part;
- performance measurement criteria which privilege longer-term performance;
- performance adjusted for risk, cost of capital and liquidity;
- clawback.

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2. Recommendation on remuneration policies in the financial services sector

B. Governance

- remuneration policy transparent internally, clear and properly documented and contain measures to avoid conflicts of interest;
- responsibility of the board;
- adequate involvement of internal control functions and human resources and, where applicable, shareholders;
- board members and other staff involved should be independent;
- staff members informed about the criteria which will be used to determine their remuneration and have access to their appraisal process;
- remuneration policy updated over time.

2. Recommendation on remuneration policies in the financial services sector

C. Disclosure

- remuneration policy should be adequately disclosed to stakeholders in a clear and easily understandable way but no particular requirements as to the form;
- Recommendation contains a non-exhaustive list of information on the main characteristics of the remuneration policy which should be disclosed.

2. Recommendation on remuneration policies in the financial services sector

D. Supervision

- supervisory review of remuneration policies within the existing powers;
- proportionality principle;
- supervisors should have access to all necessary information in order to be able to perform their review.

Proposal for modification of the Capital Requirements Directive

The objective:

- Require banks to have sound remuneration practices that do not encourage or reward excessive risk taking;
- Review of banks' remuneration policies by national supervisory authorities.

The scope:

- Credit institutions and investment firms
- Only staff that has a material impact on the risk profile of the institution

Proposal for modification of the Capital Requirements Directive (2)

General principles:

- Remuneration policy should be consistent with and promote sound risk management and not encourage excessive risk-taking
- Remuneration policy should be aligned with strategy and long term interests of the institution

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Proposal for modification of the Capital Requirements Directive (3)

Structure:

- Balance between fixed and variable remuneration;
- Deferment of major part of bonus;
- Performance adjusted for risk and cost of capital;
- Severance pay reflect performance achieved over time and does not reward failure.

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Proposal for modification of the Capital Requirements Directive (4)

Governance:

- Management board in supervisory function is responsible for remuneration policy;
- Annual review of implementation of remuneration policy.

Proposal for modification of the Capital Requirements Directive (5)

Proposal for modification of the Capital Requirements Directive is being discussed in the Council.

Council is expected to agree on more stringent principles, similar to FSB Implementation Standards.

Next steps

Directors' remuneration:

- Strict monitoring with scoreboard made public and possible mutual evaluation by MS;
- Will explore ways to improve disclosure and comparability of data by standardising disclosure requirement

Remuneration policy in FS:

- Legislative proposals modifying the existing EU legislative framework and introducing a binding obligation on financial undertakings to have sound remuneration policies subject to review by national supervisors;

For both Recommendations an evaluation report will be done by the Commission after one year

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- All texts and information can be found at The European Commission, DG Internal Market & Services website:
http://ec.europa.eu/internal_market/company/directors-remun/index_en.htm

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