

MEMO# 17135

March 1, 2004

EU COMMISSION SEEKS COMMENT ON APPROPRIATE REGIME FOR REMUNERATION OF DIRECTORS OF LISTED COMPANIES

ACTION REQUESTED [17135] March 1, 2004 TO: INTERNATIONAL COMMITTEE No. 12-04 SEC RULES COMMITTEE No. 19-04 RE: EU COMMISSION SEEKS COMMENT ON APPROPRIATE REGIME FOR REMUNERATION OF DIRECTORS OF LISTED COMPANIES On February 23, 2004, the EU Commission published a consultation document providing its initial views on several key elements of a recommendation on the remuneration of both executive and non-executive directors.¹ This consultation document follows up on the Commission's Action Plan on Corporate Governance, which proposed the adoption of a Commission recommendation on director remuneration.² The Institute is considering whether to comment on the consultation document. Comments on the Commission's consultation paper are due on April 12, 2004. Please provide any issues or concerns with the Commission's consultation document or any areas that the Institute specifically should support in a comment letter to me at (202) 326-5810 or at jchoi@ici.org by March 17, 2004.

Background According to the consultation document, the Commission has decided to develop a regulatory regime for executive and non-executive director remuneration because the conflicts of interest between shareholders and directors are not completely removed by remuneration of equity-based compensation. The Commission believes that stronger shareholder activism could help keep remuneration packages within acceptable limits and challenge them where the link between pay and performance is too weak. To facilitate more active engagement of shareholders, the Commission hopes to provide shareholders with full and accurate information combined with the appropriate mechanisms to express their views.

1 The consultation document is available at, http://europa.eu.int/comm/internal_market/company/directors-remun/index_en.htm. 2 Memorandum to International Members No. 19-03 (16124) (May 29, 2003).

2 Specific Proposals The Commission seeks comment on the following main issues.

1. Amount, Composition, and Determination of the Remuneration. As an initial matter, the Commission's recommendation will not deal with the issues of amount and structure of directors' remuneration or with the creation, composition, or role of remuneration committees.
2. Recommendation to the Member States. The Commission proposes to invite Member States to take necessary regulatory measures to ensure that listed companies comply with all its provisions.
3. Listed Companies. The Commission intends the recommendations to apply to EU listed companies but requests comment on whether the recommendations should apply to all EU companies.
- 3 4. Definition of Directors. The recommendation will apply to the remuneration of both executive and non-

executive/supervisory directors. Because of the diversity of board systems in the EU, the Commission intends to make reference to the remuneration of the “members of the administrative, managerial, and supervisory bodies by reason of their responsibilities.”

5. Disclosure of Remuneration Policy. The Commission intends to recommend that each EU listed company disclose the remuneration policy for directors to be applied for the next financial year in the annual accounts and annual report (or in the notes to the annual accounts) of the company. The Commission states that a statement of the company’s policy on directors’ remuneration should include, at a minimum:

- Details and explanation of the relative importance of the basic and performance- related (or variable) components of remuneration;
- A description of the performance criteria on which any right to options, shares or other variable components of remuneration is based;
- A justification of why such performance criteria were chosen and additional information on performance linkage;
- When any entitlement to share, share options or other incentives is not related to performance, an explanation of why this is the case;
- The main parameters and rationale for any annual bonus scheme and any other non-financial benefits;
- A description of current pension or early retirement schemes for executive directors;
- Details of and an explanation of the company’s policy on contracts, especially on the duration of contracts, and notice periods;
- Details of provisions for termination payments (and other payments linked to early termination) under such contracts for executive directors;

and 3 EU listed companies would be defined as companies with a registered office in one of the EU Member States and whose securities are admitted to trading on a regulated market according to the provisions of the Investment Services Directive.

3 • Information concerning the preparatory and decisionmaking process used for determining the company’s remuneration policy for directors. The Commission also is considering whether the information should be an explicit item on the agenda of the annual general meeting and whether it should be submitted to a vote of shareholders.

6. Remuneration of Individual Directors. The Commission intends to recommend that, with regard to executive directors or members of the management board, the annual financial statements include all financial and non-financial benefits derived from the company. Specifically, the Commission contemplates recommending the disclosure of

- (1) the total amount of salary paid or due to the director for the services performed under the preceding financial year;
- (2) the total amount of bonuses paid and total estimated value of non-cash benefits;
- (3) the compensation paid to the director in connection with the termination of his activities;
- (4) the number of share options granted by the company during the financial year and their conditions;
- (5) the number of share options exercised during that year (and for each of them, the number of shares involved and the market price of the shares in relation to which it has been exercised);
- (6) any change in the terms and conditions of existing share options during the financial year;
- (7) changes in the director’s accrued benefits under a defined-benefit pension scheme during the relevant financial year; and
- (8) details of the contributions paid or payable by the company with respect to the director under a defined-contribution pension scheme during the relevant year.

For non-executive directors or supervisory board members, the Commission intends to recommend that annual accounts contain full and detailed information on the amount and structure of the remuneration of individual members, including the structure of their remuneration policy and the extent to which it is performance-related. In addition, where share options or any other share-based schemes have been granted to non-executive or supervisory directors, a report on the reasons underlying the decision to grant such schemes to non-executive or supervisory directors.

7. Role of Shareholders Meeting. The Commission intends to recommend that variable remuneration schemes under which directors are remunerated in shares, share options or any other right to acquire shares or are remunerated on the basis of share price movements, and any substantial change in such schemes, should be subject to the prior approval of the annual general meeting of

shareholders. The Commission recommends that the approval of the annual general meeting be obtained, at a minimum, for (1) grant of share-based schemes (including share options) to executive and non-executive directors, (2) performance criteria when granting such schemes is linked to performance criteria, (3) the determination of their maximum number and the main conditions for the granting process and the term within which options can be exercised, and (4) the conditions for any subsequent change in the exercise price of the options, if appropriate and in accordance with the law. The Commission is of the view that the relevant information including either the full text of the schemes or a description of their principal terms should be communicated to the shareholders prior to the meeting.

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