

**MEMO# 17326**

April 1, 2004

## **DRAFT ICI COMMENT LETTER ON EU REGULATORY REGIME FOR REMUNERATION OF DIRECTORS**

URGENT/ACTION REQUESTED [17326] April 1, 2004 TO: INTERNATIONAL COMMITTEE No. 18-04 SEC RULES COMMITTEE No. 30-04 RE: DRAFT ICI COMMENT LETTER ON EU REGULATORY REGIME FOR REMUNERATION OF DIRECTORS Attached is a draft Institute comment letter in response to the EU Commission's consultation document on the remuneration of executive and non-executive directors.<sup>1</sup> The consultation documents provides the Commission's initial views on several key elements of a recommendation that it expects to make regarding directors' remuneration. Comments on the Commission's consultation document are due by April 12, 2004. Please provide any comments you may have on the draft comment letter to me at (202) 326- 5810 or at [jchoi@ici.org](mailto:jchoi@ici.org) by April 8, 2004. Generally, the draft comment letter strongly supports an appropriate regulatory framework for the remuneration of directors that would foster transparency regarding directors' remuneration and permit shareholders to approve certain compensation schemes that may raise particular conflicts of interest concerns (e.g., stock option plans). In addition, the draft letter responds to specific requests for comments on several enumerated issues. For example, the Institute supports the Commission's plans to invite Member States to take regulatory measures to ensure that listed companies comply with all of the Commission's recommendations. We discuss below in more detail some of the Institute's significant comments.

**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 also enumerates specific elements that should be included in a statement of the company's policy on directors' remuneration. The draft letter agrees with the Commission that the contemplated disclosure will be beneficial to investors and increase transparency. The letter, however, recommends that the disclosure include information about the remuneration policy in 1 See Memorandum to International Committee No. 12-04 and SEC Rules Committee No. 19-04 [17135] (Mar. 1, 2004). 2 effect during the period covered by the report as well as any anticipated changes to the policy for the next financial year. The letter takes the position that a description of the remuneration policy that was applicable during the period covered by the report would be helpful to investors in reviewing the annual disclosure of the remuneration of individual directors of the company as proposed by the Commission. Do members agree that disclosure should be of the remuneration policy in effect during the period covered by the report as well as any anticipated changes to the policy for the next financial year rather than of the policy to be applied for the next financial year? The letter also recommends that the disclosure include information regarding whether the management or the board has the discretion to alter

material aspects of the directors' compensation policy during the year. In addition, the letter seeks clarification whether the disclosure would be required in two separate places of the annual report or in two separate documents. The draft letter recommends that the information be contained in one document but that it would not be necessary for the Commission to specify the location(s) in the document where each item should be disclosed. The draft letter also seeks clarification whether the annual reports would be provided in connection with an annual meeting in all EU Member States.

**Remuneration of Individual Directors** The Commission intends to recommend that the remuneration of individual directors, both executive and non-executive or supervisory directors, of a company be disclosed in detail in the annual financial statements. The letter generally supports the disclosure requirements but questions why companies must explain the reasons for share-based compensation arrangements of non-executive directors. The letter expresses concern that the Commission disapproves of such arrangements in seeking justification only for these types of arrangements. The letter states that share-based compensation can include many forms of compensation, including simply paying some portion of the director's compensation in company shares, and questions why this type of equity-based compensation scheme would raise more significant issues for non-executive directors than for executive directors. The letter recommends that the Commission clarify its views on executive and non-executive compensation in this area and consider narrowing its proposal.

**Role of Shareholders' Meeting** The draft letter supports the Commission's intention to recommend that shareholders approve equity-based compensation plans. In addition, the letter suggests that non-share-based payment arrangements for the termination of employment in the event of a change in control be subject to prior approval of the general meeting of shareholders. Do members agree that companies should be required to obtain shareholder approval for "poison pills?"

**Recognition of Stock Options in Annual Accounts** Finally, the Commission intends to consider the recognition of stock options in annual reports after the adoption of the relevant International Accounting Standard, which is expected to be adopted shortly. The letter states that stock options should be reflected appropriately in a company's financial statements and that the Institute hopes that the International Accounting Standards Board will adopt a standard that would require companies to treat stock options as an expense and ensure uniformity in how stock options are valued. If the IASB, however, is unable to adopt a standard within a short period of time, the letter urges the Commission not to wait for the IASB but to recommend that companies treat stock options as an expense.

Jennifer S. Choi Associate Counsel  
Attachment (in .pdf format)