ecoDa

a.s.b.l.
Confédération Européenne des Associations d'Administrateurs
European Confederation of Directors' Associations

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Position Paper on DIRECTORS' REMUNERATION IN LISTED COMPANIES IN EUROPE

In light of the European Recommendation on Remuneration of Directors of companies, listed on European exchanges (C(2009)3177)[1], Member States have to respond by the end of 2009 on their compliance with this recommendation. To enable the national institutes of directors, members of ecoDa, to develop guidelines and promote implementation of this recommendation, ecoDa wants to take position on the subject of director remuneration. Moreover, ecoDa, wants to stimulate its member associations to promote effective remuneration practices and guide their members – board of directors - in implementing good governance principles.

The 3 D's as a guide to develop effective director remuneration

In order to implement the European Recommendation, Member States will have to reflect on the three components that are at the heart of effective director remuneration:

- **«Design»:** in terms of remuneration policy, the board of directors will be responsible for developing the remuneration structure, defining the main components and the criteria on which variable remuneration is to be based. ecoDa wants to stress the need for a well-balanced remuneration package with performance-related pay linked to sustainable success factors and variable remuneration really becoming variable. By capping the variable component, the total remuneration cost should become more 'manageable'. However, the recommendation to upgrade the fixed component in comparison to the variable remuneration, should not encourage going to the other extreme, even if it is important to cut abuses and short-term optimisation (the whole system might be distorted by increasing fixed pay; managers could become better paid but not according to their performance). By integrating non-financial as well as financial performance criteria and by introducing conditional allocation of variable remuneration, long-term and sustainable success factors will become embedded into the remuneration policy.
- **« Decision process»:** the board should carefully reflect on the question who decides on what, and especially pay attention that there is independence and sufficient checks and balances on each level of decision-making on remuneration. Nobody should be allowed to decide on his or her own remuneration. Moreover the board should develop the shareholders' say on pay (see further). To this end the board will be advised by the remuneration committee on all matters in relation to design, decision and disclosure on director remuneration. Whenever judged necessary, the remuneration committee can rely on external advice. The remuneration committee has to ensure that it benefits from the best advices needed; like the Audit Committee the remuneration committee will have to check the independence of its advisors (like the audit

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

committee checks the independence of auditors).
- **« Disclosure»:** external accountability is growing in importance, certainly on the subject of director remuneration, leading to increased focus on true transparency. However one should be aware that more information does not by definition lead to better transparency. A cost-benefit analysis of the effectiveness of remuneration disclosure as well as the development of disclosure frameworks may improve effectiveness of transparency. ecoDa wants to urge its members to (help) develop useful guidance on effective transparency.

ecoDa wants to stress the need for a 'strategic remuneration philosophy'

Companies as well as regulators should be aware that there is no such thing as a 'one size fits all' remuneration policy, based on a copy-and-paste approach of practices in other companies and countries. Designing an effective remuneration policy supposes that there is a fit with the corporate objectives and goals by translating such goals and strategic ambitions into relevant performance criteria and reference data.

ecoDa wants to promote effective 'say on pay'

Monitoring director and executive remuneration deserves much more attention than ever before. Given that no individual should decide on his or her own remuneration, ecoDa wants to promote a clear distinction between the role of the board of directors and the role of the shareholders' meeting in monitoring director and executive remuneraton.

Shareholders monitor the board of directors. Consequently, for what concerns the **remuneration as a member of the board of directors** (whether for non-executive or executive directors) it is clear that the final approval should be with the shareholders meeting (shareholders have to decide on the remuneration policy as well as on its application in practice).

However, it is the board of directors that has to monitor the executives. Consequently, for what concerns the **remuneration as an 'executive'** (whether such executive is a member of the board of directors or not), the first monitoring duty lies with the board of directors. To this end, boards of directors should endeavour to reach best practices, such as:
- be advised by a remuneration committee, composed of only non-executive directors, in majority being independent;
- be attentive to the independence of outside remuneration advisors;
- the structure of the remuneration policy should be such that there is an alignment with the strategic goals and ambitions;
- the application of such policy -for each of the relevant executives- should be developed with the long term success in mind, while also considering potential risk and moral hazard effects;
- boards of directors should foster that shareholders support the long term success of the corporation and its translation into the remuneration policy and practice.

Moreover shareholders will be involved in the following aspects of executive remuneration:
- shareholders should be informed on the remuneration policy in the governance statement (or governance charters) and on its application through the publication – as part of the annual report – of the remuneration report;
- such remuneration report should be an explicit item in the general shareholders' meeting;
- for what concerns the variable component in the form of shares or share options, shareholders should approve the share-based benefit schemes, before

distribution of such remunerations. Within this available envelop, it is up to the board of directors to decide on the grants to individual executives.

Finally, shareholders will always have the last word, since they will ultimately decide on the nomination and dismissal of directors, as well as approve the annual accounts.

Additional points of attention for implementing the European recommendation

- One may not neglect tax and social security differences within the EU, when adapting or changing the remuneration policy. Changes in remuneration structure are not always tax neutral.
- Companies should be aware that applying the new recommendation will not be neutral in terms of legal consequences. The terms of the contract will have to be rethought.
- There is a need for developing new performance frameworks and guidelines for measuring quantitative as well as qualitative performance. At the same time such frameworks should allow to integrate relevant risk/return ratios. To this end, more attention should be paid to adapting enterprise risk management models as well as balanced scorecard frameworks.