On the Remuneration of Directors of Listed Companies (Again)

TOM DIJKHUIZEN, PHD-FELLOW IN COMPANY LAW AT LEIDEN UNIVERSITY, THE NETHERLANDS*

On 9 April, the European Commission published a proposal[1] for the revision of the Shareholder Rights Directive.[2] This revision was already announced in the Commission's Action Plan[3] to modernize the company law and corporate governance framework and in particular to enhance transparency and to engage shareholders. As the overarching objective of the proposal is to contribute to the long-term sustainability of EU companies, to create an attractive environment for shareholders and to enhance cross-border voting by improving the efficiency of the equity investment chain in order to contribute to growth, jobs creation and EU competitiveness, the realization of more specific objectives is required.

The Commission distinguishes five specific objectives: (i) to increase the level and quality of engagement of asset owners and asset managers with investee companies; (ii) to enhance transparency and shareholder oversight on related party transactions; (iii) to ensure reliability and quality of advice of proxy advisors; (iv) to facilitate transmission of cross-border information (including voting across the investment chain in particular through shareholder identification; and (v) to create a better link between pay and performance of company directors. This last objective has become a recurring one.

After a number of corporate scandals at the turn of century, in particular the *Enron* scandal, directors' remuneration was addressed by the High Level Group of Company Law. The Group already recommended, on 4 November 2002, that the Commission should adopt a Recommendation defining an appropriate regulatory regime for directors' remuneration including provisions concerning the disclosure of the individual remuneration of both executive and non-executive or supervisory directors and the remuneration policy in the financial statement of the company, whereby the latter is an explicit item for debate on the agenda of the annual meeting.[4] The Commission adopted accordingly Recommendation 2004/913/EC[5] that encompassed provisions, *inter alia*, the disclosure of a statement of the remuneration policy of the corporation, which should be submitted to the annual general meeting of shareholders for a vote. Ten years later, the Commission is of the view that a number of elements of corporate governance 'should in view of the cross-border relevance and the importance be dealt with at European level in *a more binding form* to ensure a harmonised approach across the EU (e.g. shareholder identification, the transparency and engagement of institutional investors and board remuneration)' (italics added).

As the aim of the proposal is to create a better link between pay and performance of company directors, the proposal gives shareholders of listed companies more influence over directors' remuneration. Firstly, the proposal consists of a provision, Article 9a, that grants shareholders the right to approve the remuneration policy and companies should only pay remuneration to their directors in accordance with a remuneration policy that has been approved by shareholders. It should be ensured that this policy is a clear, understandable and comprehensive overview of the company's remuneration policy and that this policy is also in line with the business strategy, objectives, values and long-term interests of the company. Moreover, this provision entails that the remuneration policy must explain the ratio between the average directors' remuneration and the average remuneration of full time employees of the company other than directors.

Secondly, another provision, Article 9b, grants shareholders the right to vote on the company's remuneration report and where the

* Email: t.c.a.dijkhuizen@law.leidenuniv.nl.

1 The European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34 as regards certain elements of the corporate governance statement*, COM(2014) 213 final.

2 *Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies*, 2007 O.J., L 184/7.

3 The European Commission, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies*, COM(2012) 740, final, pp. 8–10.

4 The High-Level Group of Company Law Experts, *Report of the High-Level Group of Company Law Experts on a modern Regulatory Framework for Company Law in Europe*, Brussels, 4 Nov. 2002, *available at* http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf , p. 76.

5 European Commission, *Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies*, 2004 O.J., *L* 385/55.

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shareholders vote against the remuneration report, the company should explain in the next remuneration report how the vote of the shareholders has been taken into account. Yet again, it should be ensured the remuneration report should be clear and understandable and the report should provide a comprehensive overview of the remuneration granted to individual directors in the last financial year.

How will we go from here? It is clear that the proposed provisions will fall on more fertile ground than their predecessor. The objectives have been formulated after consultations with market participants, in particular investors, and further analysis by the Commission. Therefore the proposal probably will be welcomed. With regard to the provisions on say-on-pay, it will be the same story, as national authorities already see it as an instrument to increase the level of shareholder engagement. For instance, in Germany the enactment of the Executive Compensation Act already established a say-on-pay mechanism. Are the good times ahead of us?