EuropeanIssuers

aisbl - ivzw
Rue Belliard 4-6
B-1040 BRUSSELS

Tel : +32 (0)2 289 25 70
Fax : +32 (0)2 502 15 60

info@europeanissuers.eu
www.europeanissuers.eu

EUROPEANISSUERS POSITION ON THE DRAFT GUIDELINES ON THE STANDARDISED PRESENTATION OF THE REMUNERATION REPORT

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INTRODUCTION

EuropeanIssuers members believe that the draft guidelines on the standardised presentation of the remuneration report have been significantly improved in the past months. The Company Law Expert Group meeting that took place on 20 September 2019 provided an excellent opportunity for its participants to exchange views and find a common denominator that can work in all markets and how to proceed forward.

It is important to reiterate that companies are already subject to various EU and local rules requiring reporting on remuneration components, in some cases on individual basis, with different reporting standards. Therefore, EuropeanIssuers presents below additional comments containing important adjustments in order to make the guidelines:

- more flexible;
- compliant with various obligations;
- serve different purposes; and
- become future proof.

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POSITION

According to the Directive, the report shall include all benefits in whatever form **awarded or due during** the most recent financial year to individual directors.

As a general comment, EuropeanIssuers would like to invite the Commission to perform a “dry run” with these tables with real data to see whether the tables and all required information will lead to a comprehensive, insightful and readable report.

§4. Addresses

It is important to recall to whom these guidelines are addressed. However, we would advocate for deleting any reference to other companies that are outside the scope of the directive.

§ 5. Key principles

Regarding principle 2, "**Standardised presentation of the Report**", it is said that if there is nothing to report for a specific section, table or data field, such part can be left blank in the Report. We fear that this method would lead to numerous elements left blank. For instance, some CEO's do not receive any stock options or bonus shares. We do not see the need in that case to disclose blank tables that would weigh down the presentation.

Principle 7 needs to be supplemented with a sentence saying that "the salary of the director, in his capacity as an employee of the company, shall not be included in the report".

§ 6.1. Introduction

The introduction requires a wide range of information (about the effective performance of the company, the key events in the company's operations, the business environment) in order to put the directors' remuneration into context. However, this information is already provided elsewhere in the annual report, and specifically in the management report. Therefore, companies should have the possibility to make cross-references to the relevant information published in the management report. This is of paramount importance due to the fact that providing a summary of such a complex information in a few lines could be misleading. In our view, the introduction should be used to explain the activities of the remuneration committee during the last financial year and how the remuneration policy has been implemented.

Having a remuneration policy report and a separate financial report is welcomed but including a summary report in the remuneration report might not be practical.

§ 6.2. Total remuneration of Directors

In §6.2.2, it is said that table 1 should be split into two parts with the executive directors listed in the first part and the non-executive directors in the second part. It seems more appropriate to make two separate tables, one for the Executive Directors (EDs) and one for the Non-Executive Directors (NEDs). Requiring all the information to be provided in one table would result in a very long and rather confusing table. Moreover, "not applicable" will need to be stated many times. The explanation already seems to acknowledge this, as it states "as many of the individual components of the remuneration may not apply to the latter". As a consequence, the setting up of two separate tables would be more logical and provide better insight.

According to the guidelines, payments to former Directors should be included in the Remuneration Report. However, it does not seem logical to include information regarding these former directors in the same table 1 as for active directors. First of all, they are no longer directors. Secondly, they no longer contribute to/are not responsible for the performance of the company. Therefore, a link between their remuneration and the performance of the company is irrelevant.

It is interesting to mention that, for example, under the UK law these former Directors are not included in the Single Figure Table either but in a separate chapter of the report. The same applies for table 3 and 4.

Information on previous employment contracts or severance should be deleted from "Extraordinary Items" as this information is not relevant.

Variable remuneration

In order to compute the director's total compensation during the reported financial year, the guidelines require taking into account the variable remuneration paid and the shares and share related instruments vested during the reported financial year (cf. page 7 and 8).

In this regard, it should be noted that the most relevant information for investors consists of connecting the variable component to the financial year in respect of which it is calculated, even if it is paid during subsequent financial years.

The wording of Art. 9b "during the financial year" does not lead to another interpretation but emphasises that remuneration paid according to plans of previous years is not in the scope of Art. 9b: Art 9b does not say "awarded or due or vested or paid". As recital 33 indicates, investors need to be able to assess the link between pay and performance and Art. 9b has to be read in this context. If the EU Commission wants to change the scope of Art. 9b into "any payment" received by directors in a "fiscal sense" or "income tax perspective" during a financial year this would result in a disconnection of information on pay and performance. Therefore table 1 must show remuneration "with respect" to a certain financial year in order to enable a pay for performance assessment. This will not lead to a loss of the information as such to investors but to an allocation in remuneration reports of other financial years.

Furthermore, the Commission should establish a definition for "vested"[1] in order to guarantee legal certainty.

This is important for various reasons:

- The annual performance of the company affects the amounts allocated to the executives and not the amounts vested;
- The board of directors decides each year on the amounts allocated and not the amounts vested which are the results of applying criteria defined under past decisions and are subject to separate disclosure.

In addition, it should be noted that credit institutions and investment firms (as defined in point 3 of Article 4(1)(3) of Regulation (EU) 575/2013, which are subject to Directive 2013/36/EU) should also apply the Guidelines on sound remuneration policies adopted by European Banking Authority ('EBA').

Thus, these institutions and firms have an obligation:

- to respect the "EBA ratio" (ratio between fixed/variable remuneration granted with respect to each financial year even though it is paid/vested in the following years). This means that the CRD4 directive requires to calculate a ratio between variable and fixed compensation taking into account the amounts of variable compensation awarded in respect of and not those paid during that financial year;
- to defer the payment/vesting of the one-year variable compensation over 3 years after grant and to award a portion of this one-year variable compensation in shares or share-related instruments.

[1] For example, the EBA guidelines indicate "Vesting means the effect by which the staff member becomes the **legal owner** of the variable remuneration awarded, independent of the instrument which is used for the payment or if the payment is subject to additional retention periods or clawback arrangements" – reachable also here

For these institutions, changing this approach in these guidelines would lead to inconsistency in European requirements and serious confusion by:

- mixing the remunerations granted (and related to the performance) during different fiscal years and
- resulting in the impossibility to identify the total amount granted with respect to the performance in the reported financial year.

Regarding one-year variable remuneration, if these institutions follow the present guidelines on standard presentation of remuneration, they should report in column "One-year variable" the elements (cash payments/shares vested) corresponding to different financial years.

Regarding multi-year variable remuneration, which is granted with respect to the financial year but vested by instalments over few following years, the cumulated amount reported in the column "Multi-year variable" will cover the remuneration (cash or shares) granted in different financial years.

This could cause the following issues:

- Lack of information for shareholders on the amount of remuneration granted with respect to the directors' performance for the reported financial year;
- Confusing information on fixed/variable remuneration ratio for financial institutions (EBA ratio);
- Disruption in the communication approach on directors' remuneration;
- Inconsistency regarding the comparative information provided in table 5 (the Director remuneration's amount for each reported financial year will be actually a cumulated amount of the paid/vested instalments granted for different previous years).

Therefore, companies should be allowed to disclose **the compensation awarded in respect** of the financial year.

Extraordinary items: it is not clear whether the information regarding severance and termination payment must be disclosed only at the time of the departure or in any case. In our view, this information should be disclosed only when the termination effectively takes place and the amount is paid.

Pension expense: In Table 1 the computation of the directors' total remuneration includes "Pension expense". We understand that the guidelines mean to include in this column employer contributions to mandatory pension schemes (cf. page 8 "Where applicable, the note should also explain what part of the pension contribution during the reported financial year relates to financing of a mandatory or statutory pension").

We believe that the contributions to mandatory legal schemes (in France for instance: "retraite de base", "ARRCO/AGIRC",…) should be excluded from "Pension expense" (these schemes being subject to legal rules and applicable to all employees of the company).

Therefore, it would be more consistent to refer only to supplementary pensions and not mandatory pensions.

Also, it seems that the explanations only refer to "defined contribution" schemes. "Defined benefit" pension schemes need to be taken into account also.

<u>Proportion of fixed and variable remuneration</u>: it is said that *"In order to illustrate how the director's remuneration contributes to the long term performance, it is recommended that the relative proportion of short and long term remuneration is provided separately where long term performance criteria relate to at least 5 years performance*". It is not clear what it means here. Should a distinction also be made between short term variable and long-term variable where long term performance criteria relate to at least 5 years performance? In any case, it seems to be a new requirement, not prescribed by the Directive.

§ 6.3. Share-based remuneration

§6.3.1 states that the Report shall contain information on the number of shares and share options granted <u>or offered to directors</u>. It is not clear what the term "offer" refers to. This wording should be clarified.

In §6.3.3, it is written that besides the directors who have performed their mandate during the reported financial year, table 2 and 3 should provide information of former directors as well. It should be clarified that the information required is only at the time of their departure, information regarding the amount of shares they hold and the main features of the plan. Insofar as options and bonus shares plans last for about 10 years, it would lead to lengthy reports, if it was required to give information concerning for instance the exercise of options for former executive directors who have left the company 5 years ago.

In §6.3.5, it is said that "although there is no consensus in the current practice as to whether the fair value (determined according to IFRS 2 methodology for accounting) or the market value is the most suitable to use, in the interest of transparency companies are advised to reflect in the report the market value of shares or underlying shares in the case of share options, at the time they are granted, are offered or vest, as applicable".

In some jurisdictions, the "fair value" methodology prevails and is recommended by market authorities and applied in accordance with accounting standards (esp. on the value of financial instruments) used in connection with the preparation of financial statements. There is no rationale for changing this market practice, which takes into account the probabilities of not achieving all performance criteria. Changing the approach would introduce inconsistency between the valuation included in the remuneration report and the valuation made of the same financial instruments (audited by the statutory auditors) in the financial statements. As a compromise, companies should be entitled to refer to IFRS 2 and have the option to include the market value of the shares (but only at the time they were granted as neither the Board nor the management has control over its subsequent evolution) as a footnote without placing it on the same level as the "fair value" methodology.

§ 6.5. Information on how the remuneration complies with the remuneration policy and how performance criteria were applied

Regarding Table 4, EI considers that it is meaningless for shareholders to have in separate tables:

- on the one hand, the description of the variable remuneration or the description of the incentive plans;

- on the other hand, the performance criteria that apply to each remuneration component.

Performance criteria are directly linked to the design of LTIPs. Investors need to have in the same table a comprehensive description of each component of the remuneration including the performance criteria that apply to it.

The combination of criteria is not necessarily only additive, which seems to be taken into account in the design of table 4, but also multiplicative. “Multiplicative” means that one performance measure might be increased or diminished depending on the realisation of another measure. We wonder how such interconnection can be inserted in table 4.

Lastly, we welcome that the new version of table 4 now clarifies that disclosure of minimum and maximum performance targets must be understood as “optional”.

§ 6.6. Derogation and deviations from the remuneration policy and from procedure for its implementation

Clarification could be provided regarding the type of exceptional circumstances that permit to derogate from the remuneration policy.

§ 6.7. Comparative information on the change of remuneration and company performance.

Again, it seems better to include in a separate table the Non-Executive Directors.

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We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer-term. We seek capital markets that serve the interests of their end users, including issuers.

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