REMUNERATION AND THE SHAREHOLDER RIGHTS DIRECTIVE

The transposition of the revised Shareholder Rights Directive into the national legislation of EU member states is expected to bring about a standardised regulatory framework across Europe, ranging from executive remuneration to related party transactions across Europe.

When it comes to executive remuneration, the revised Shareholder Rights Directive is aimed at encouraging a higher standardised level of disclosure and greater accountability over directors’ pay. As a result, the requirements are implemented via member states’ national legislation, minimum standards on shareholders’ remuneration (including all benefits in whatever form) awarded or due during the last five financial years; the number of equity instruments granted or offered and the main conditions for their exercise; information on applicable claw-back provisions; and, lastly, information on any deviation from the remuneration policy.

Where a company awards variable remuneration, the remuneration policy should include a description of the components of fixed and variable remuneration, including bonuses and other benefits, which may be awarded to directors while also indicating their relative portion in a clear and understandable way. The remuneration policy should explain the decision-making process followed for its determination, review and implementation, including measures to avoid or manage conflicts of interests and, where applicable, the role of the remuneration committee or other committees concerned. Where the policy is revised, it should describe and explain all significant changes and how it takes into account the votes.

As for the remuneration report, this shall include a comprehensive overview of remuneration (including all benefits in whatever form) awarded or due during the most recent year to each individual director. The report shall also include the total remuneration of each individual director split into component parts (fixed and variable, and their relative proportion); information on the application of the performance criteria; the annual change in remuneration in relation to the performance of the company and the change of employee remuneration over the last five financial years; the remuneration deriving from undertaking within the same group of companies; the number of equity instruments granted or offered and the main conditions for their exercise; information on applicable claw-back provisions; and, lastly, information on any deviation from the implementation of the remuneration policy.

The European Commission has run a consultation on guidelines that are aimed at harmonising companies’ annual disclosure for directors’ remuneration. The consultation ended on 21 March 2019 but no indication of when a final draft of the guidelines will be published has been provided by the European Commission yet.

Germany

Currently, in Germany there is no mandatory requirement for annual shareholder approval on executive compensation. As stated previously, national regulation provides that shareholders may only vote on the remuneration system on a regular basis or where a notable change is implemented. The draft law for the implementation of the revised Shareholder Rights Directive is expected to bring about a number of notable changes.

In compliance with the German corporate law and governance structure, the draft implementing law (published on 11 October 2018) sets forth different rules for the remuneration of the management board and that of supervisory board members. According to the provisions of the draft implementing law, the supervisory board members’ remuneration is to be determined by the shareholders at the AGM while the remuneration of the management board members is to be determined by the supervisory board in consultation with the management board. A draft advisory vote on executive remuneration, review and implementation, including measures to avoid or manage conflicts of interests and, where applicable, the role of the remuneration committee or other committees concerned. Where the policy is revised, it should describe and explain all significant changes and how it takes into account the votes.

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Looking at current practice in Germany, it is notable that from 2010 to 2019, fewer than 100 votes on remuneration were undertaken in the DAX 30 index. Germany’s situation as a latecomer in terms of giving shareholders a say with regard to the remuneration of directors is even more striking when we consider that in the 2019 AGM season only four DAX 30 companies submitted a remuneration system to their shareholders for a vote.

Some investors have argued that a gradual introduction of voluntary voting over remuneration matters would have helped to smooth the transition towards a more developed shareholder franchise on remuneration of directors. As things stand, it is now clear that German companies will potentially be in for a rude awakening when shareholders are given a vote on their pay unless they swiftly get up to date with international standards of executive remuneration prior to the next AGM season.

**Netherlands**

In the Netherlands, national law implementing the provisions of the revised Shareholder Rights Directive is currently going through parliament. At the time of writing, the current draft implementing law provides that a binding shareholder vote shall be put forward at least every four years and this provision will be applicable both to the remuneration policy of the management board members and that of the supervisory board members (or to non-executive directors where the company has a unitary board structure).

Among the most notable features of the draft implementing law, is that it requires there not only that the vote on the remuneration policy be binding but that the remuneration must be adopted with a qualified majority of 75 per cent of the votes cast (unless otherwise provided by the articles of association). Such a high threshold for approval of the remuneration policy is likely to set Dutch companies on a learning curve to implement international best practice standards of remuneration to ensure their policies are approved with very comfortable majorities in the years to come.

**Conclusion**

As member states implement the provisions set forth in the revised Shareholder Rights Directive for remuneration of executives, best practice for remuneration of executives becomes more and more institutionalised.

Moreover, since the introduction of the first annual remuneration votes (many major European markets had already introduced some form of annual remuneration votes: 2002 in the UK, 2010 in Spain, 2011 in Italy and 2013 in France and Switzerland), the demands of proxy advisors and institutional investors have steadily increased, both in terms of transparency and best practices, to which the companies in these markets have had to respond with significant improvements.

While France was granted a grace period during the first year of introduction of the new remuneration votes (in 2014 remuneration resolutions garnered an average of 92 per cent across the board), this seems less likely to happen for Germany and the Netherlands – the two most prominent markets still lagging behind in terms of executive remuneration votes may have to swiftly adapt to the new reality.

As both the proxy advisors’ and investor-specific guidelines have become stricter and stricter on remuneration, German and Dutch companies will be forced to prepare for unseen challenges from investors and proxy advisors. The two markets will need to come to terms with the new requirements, not just through national implementation of the revised Shareholder Rights Directive but also by the investor community and its own sophisticated and ever-developing approach to executive remuneration.

**Transparency for Institutional Investors**

German and Dutch companies will confront unseen challenges on their remuneration votes in 2020.