

Focus on remuneration – prepare for SRD II

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Annual Remuneration Votes Across Europe

This map shows which of the seven largest European markets hold annual remuneration votes and the year in which they were introduced.

- Annual Remuneration Vote
- No Annual Remuneration Vote



Shareholder Rights Directive II

Remuneration resolutions (1/4)

The directive amends the existing EU Shareholder Rights Directive and, **with respect to remuneration**, shareholders will be given the option to express their views on executive remuneration through **two votes**:

Remuneration Policy

- > binding or advisory depending on Member State implementation of SRD II
- > must be submitted for a vote at least every 4 years
- > if binding vote fails, company shall revert to its prior approved remuneration policy and submit a revised policy at the next shareholders' meeting

Remuneration Report

- > advisory pursuant to the provisions of SRD II
- > must be submitted to a shareholder vote annually
- > if the remuneration report fails, the company must explain in the following remuneration report how it has taken into consideration the negative vote of shareholders

Amongst the states not yet having an annual vote on remuneration, in October 2018 the Netherlands' government published a proposal for implementation of SRD II which, inter alia, included:

- > 4-yearly binding vote on the remuneration policy, to be approved by at least 75% votes cast; and,
- > mandatory consultation with the work council before the item can be put on the agenda.

Shareholder Rights Directive II

Remuneration policy (2/4)

The directive states that the remuneration policy should “contribute” to a company’s **business strategy, long-term interest**, and **sustainability** and the company will have to explain how it does so. Amongst others, the policy shall contain the following:

Fixed and variable components	> detailed description of fixed and variable components and their relative proportion
Variable remuneration specifics	> comprehensive and valid criteria for award > vesting period and retention period if share-based, deferral periods and claw-back (if any)
Performance criteria	> financial and non-financial performance criteria and how they contribute to the overall business strategy
Relation with employees’ pay	> consideration given to pay and employment of employees when establishing directors’ pay
Contractual arrangements	> duration and terms of contractual arrangements, including notice periods > any supplemental pensions and early-retirement schemes, termination payments

Moreover, the policy shall disclose information around the process and methods adopted for its **determination** and **revision**:

Decision making process	> determination, review, and implementation including measures to avoid conflicts of interests and role of the remuneration committee
Revision process	> when revised, description and explanation of any significant revision and how it addresses shareholders’ view expressed at the most recent vote taken

Shareholder Rights Directive II

Remuneration report (3/4)

The remuneration report shall include a comprehensive overview of the remuneration of individual directors, awarded or due during the most recent financial year (including total remuneration split by component, annual change in remuneration and company performance, share-based awards and possibility to reclaim variable remuneration). As the SRD II is not always explicit and Members States are given some discretion in implementing it, the European Commission has published draft guidelines for its implementation with the aim of standardizing the presentation of the remuneration report. These non-binding guidelines recommend remuneration reports to include:

General Overview	<ul style="list-style-type: none">> key company events and performance, including any event affecting the remuneration of directors> how the vote or views of shareholders were taken into account in determining the remuneration of directors
Total Individual Remuneration	<ul style="list-style-type: none">> each director's remuneration split out by: fixed remuneration, variable remuneration, total remuneration and proportion of fixed and variable remuneration
Performance Criteria and Outcomes	<ul style="list-style-type: none">> description of financial and non-financial performance criteria and type of applicable remuneration and relative weighting> actual performance as measured and effective outcome once the performance criteria are applied
Share Based Awards	<ul style="list-style-type: none">> key elements of share-based remuneration (i.e. number of shares and instruments granted, main conditions for the exercise of the rights etc.)
Malus and Claw-Back	<ul style="list-style-type: none">> information on the right to reclaim variable remuneration (e.g. malus or claw-back)
Derogation from the Policy	<ul style="list-style-type: none">> information and explanation of any deviations from the procedure for the implementation of the remuneration policy
Information on Shareholder Vote	<ul style="list-style-type: none">> information on how the company has taken into account the shareholder vote on the last remuneration report adopted

Shareholder Rights Directive II

Implementation in Germany (4/4)

The **draft German implementing law** sets different rules for the determination of the remuneration of management board members and that of supervisory board members.

Supervisory Board

> remuneration of the supervisory board is determined by the shareholders at the AGM (resolution to contain same level of information as remuneration policy for management)

Management Board

> remuneration of the management board is determined by the supervisory board in accordance with the policy voted upon by shareholders

The **remuneration policy** shall be subject to an **advisory vote** of shareholders **at least every four years**.

If the vote fails, a **revised** remuneration policy must be submitted at the next AGM

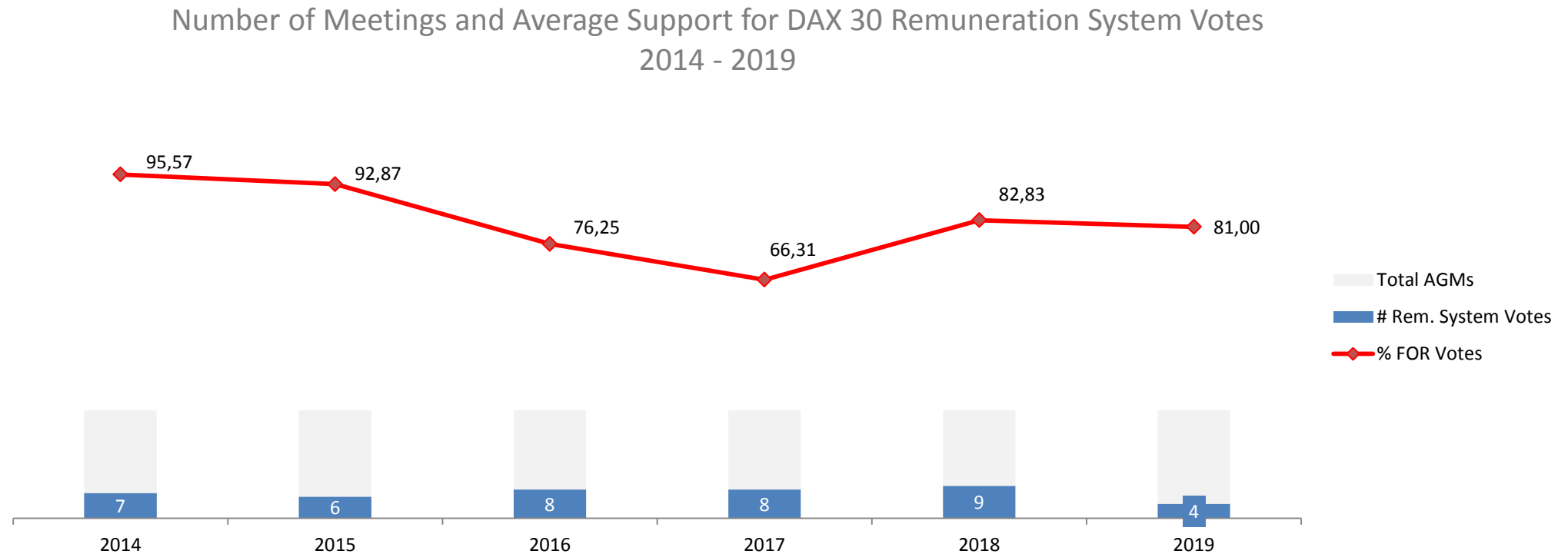
The draft implementing law moreover provides that the supervisory board and the management board are jointly obliged to draft an **annual remuneration report** which shall be **annually** subject to an **advisory shareholder vote**. The remuneration report shall contain:

retrospective information on the remuneration of both supervisory board members and management board members individually

information regarding the ratio of the average remuneration of directors vs that of employees over a 5-year period

Remuneration System Votes in Germany – Status Quo

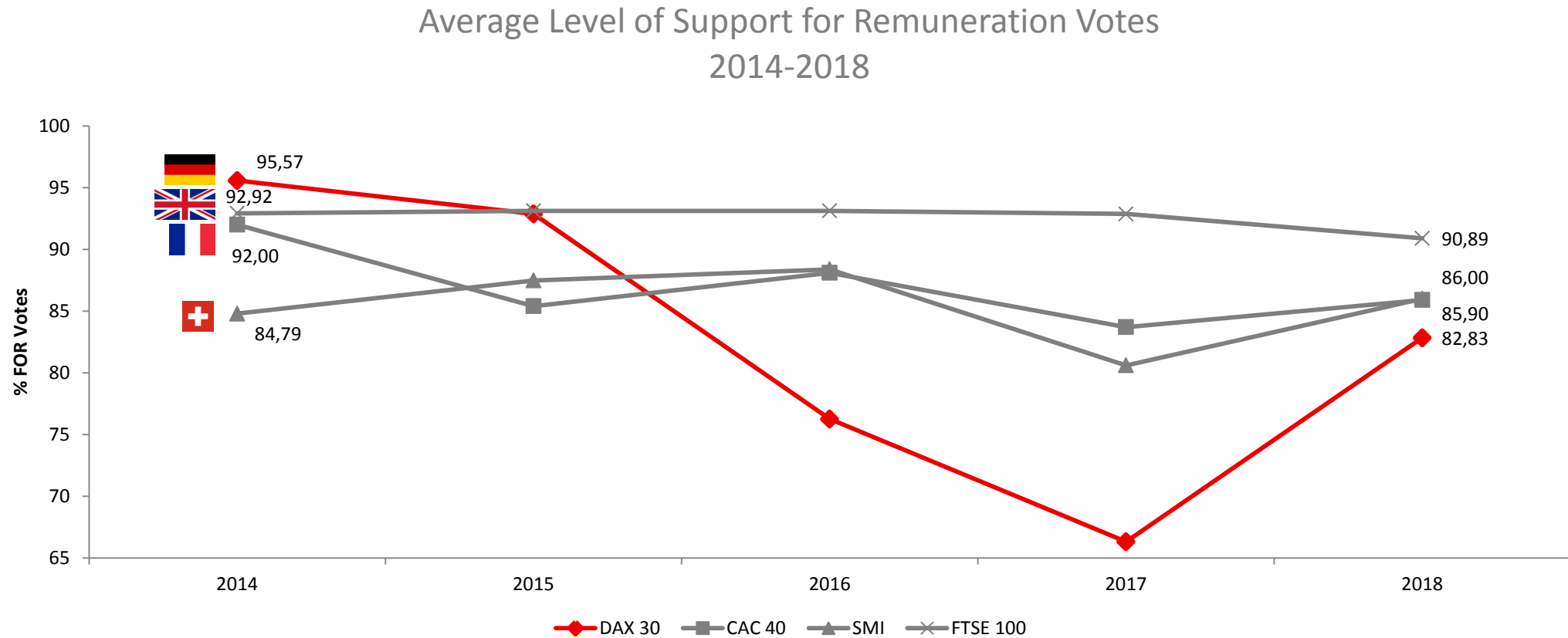
Both low number of votes and low level of support for remuneration system votes in the DAX 30



- > Between 2014 and 2019, a yearly average of only 7 DAX 30 companies held remuneration system votes at their AGMs.
- > These companies are not a representative sample, however. They chose to hold a remuneration system vote even though it was not obligatory.
- > SRD II will force all companies to hold a vote.

European Remuneration Votes

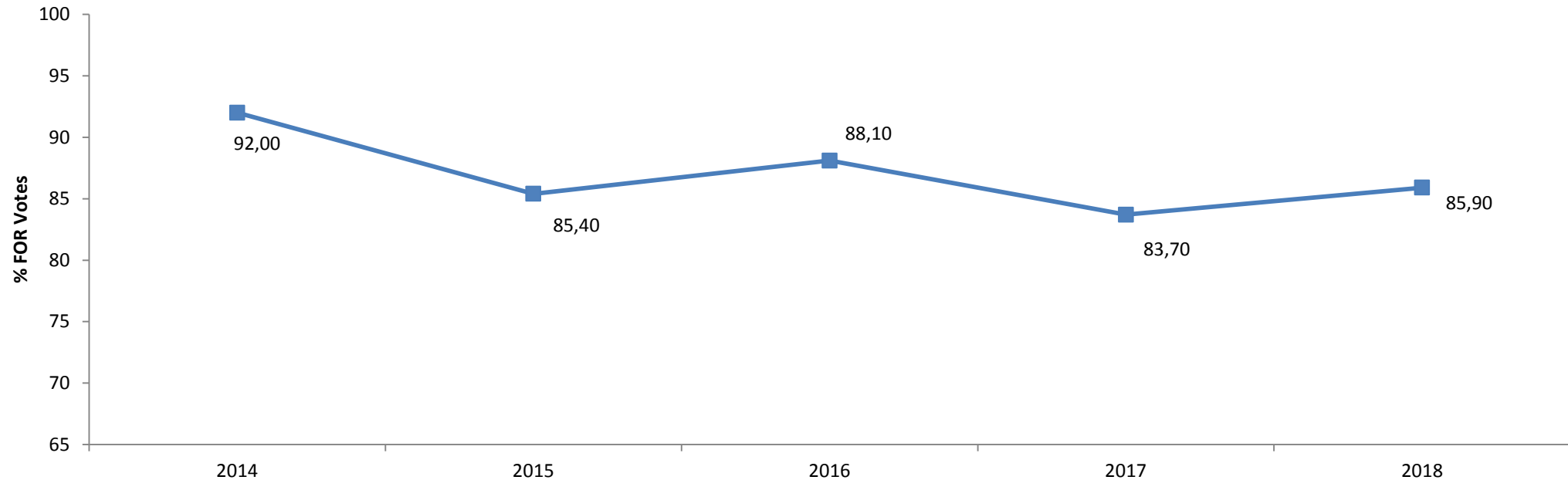
Germany has lagged behind the rest of Europe on level of support for remuneration votes.



Remuneration System Votes in France

Since introduction of annual votes on remuneration, support in France has remained low

Average Level of Support for Remuneration Votes in France
2014-2018



- > In 2014, some investors and proxy advisors stated their intention to take a somewhat more lenient approach on these newly introduced remuneration votes when compared to the rest of Europe.
- > This was reflected in an average of 92% of votes in favour of CAC40 remuneration resolutions.
- > After this initial grace period, however, investors have applied strict guidelines to France in line with the rest of Europe. This has led to an average level of support of 85.78% between 2015 and 2018.

Remuneration Report Development

Disclosure has improved significantly across European markets with annual remuneration votes

Barclays 2002 Remuneration Report

Annual bonus performance conditions



Barclays 2018 Remuneration Report

Annual bonus performance conditions



Annual bonus including Executive Share Award Scheme (ESAS)
 The annual bonus for executive Directors is linked to Group economic profit performance and individual performance. Bonuses (including ESAS) for 2002 were 67% of base salary at 31st December 2002 for the Group Chief Executive and between 50% and 62% of base salary for other executive Directors. This represents a total reduction in executive Directors' bonuses of 39% since the previous year.

Minimal detail of performance condition. Covered by one sentence:

"The annual bonus for executive Directors is linked to Group economic profit performance and individual performance."

Five pages of quantifiable and externally verified financial and non-financial performance conditions.

This level of disclosure has become expected by institutional investors.

Changes to the German Corporate Governance Kodex

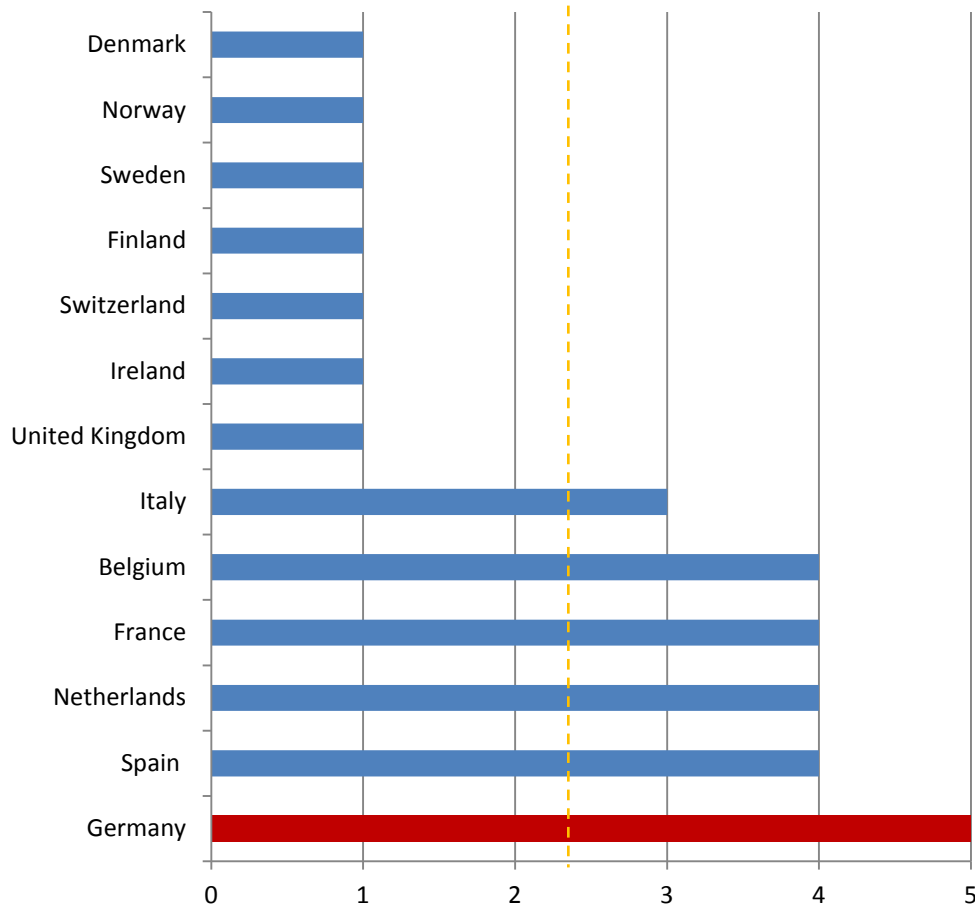
Executive Remuneration: Key provisions of the updated Kodex

- › The target total remuneration comprises all remuneration components, and represents the amount granted in case of full target achievement.
- › The target total remuneration is supplemented by a maximum remuneration (cap).
- › Total target remuneration and maximum remuneration shall be communicable overall in comparison to the remuneration of other senior managers and the employees, and should be explainable to the general public.
- › In general, total remuneration comprises fixed and variable performance-related components.
- › Variable remuneration is the key material incentive for pursuing the objectives of business policy. It acts as the motivation and reward for specific actions, for operating performance, for a strategic orientation that promotes the long-term development of the company, and for responsible behaviour. Accordingly, the performance criteria also comprise sustainability targets.
- › Moreover, the Code will include a recommendation that going forward, the share of long-term variable remuneration shall exceed the share of short-term variable remuneration.
- › The long-term variable remuneration amounts of Management Board members shall be largely invested in company shares by the respective Management Board member, or shall be granted by the company as share-based remuneration.
- › An initial draft proposal (according to which long-term variable remuneration shall be solely granted in company shares the volume of which shall depend on the execution of strategic initiatives and measures during the year under review), has not been included.

Changes to the German Corporate Governance Kodex

Term length: Updated Kodex keeps Germany as outlier in Europe for board term length

Board term length across Europe in years
(common practice)



- > In the initial draft of the new German Corporate Governance Kodex, it was proposed that supervisory board terms be set at 3 years, from the current norm (and legal maximum) of 5.
- > This was scrapped following corporate opposition and the current provision (no recommendation regarding term length) was maintained.
- > This turnaround is likely to attract criticism from institutional investors who have become accustomed to far lower term lengths across Europe.
- > State Street made clear last year that this was a focus area for them:

Within Europe, board accountability is weakest among German companies, where directors stand for election only once every five years.

The excessive terms of office in Germany and other European markets will be a key area of focus for SSGA's Asset Stewardship Team for the following year.

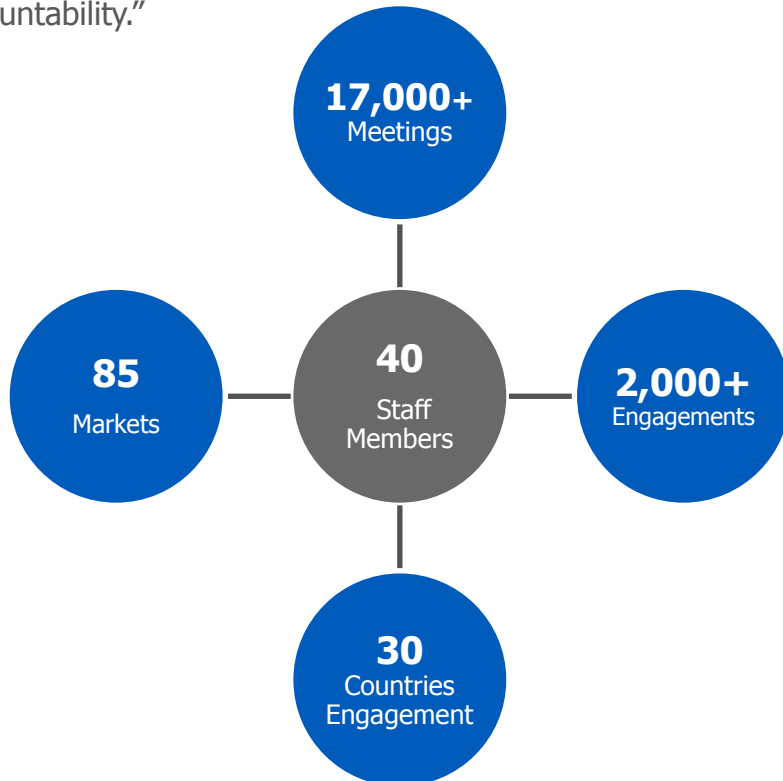
- > Maintaining the 5 year norm may lead to a number of potential effects:
 - > Further use of the annual discharge vote to express investor dissatisfaction;
 - > Investors might use the new remuneration votes to express frustration with the Supervisory Board;
 - > Increasing the investor perception of Germany as a laggard in terms of governance practices and shareholder responsiveness.

Investor Expectations

Challenges

BlackRock®

"BlackRock, as a fiduciary investor, undertakes all investment stewardship engagements and proxy voting with the goal of protecting and enhancing the long-term value of our clients' assets. In our experience, sustainable financial performance and value creation are enhanced by sound governance practices, including risk management oversight and board accountability."



"An index fund tracks its benchmark index and therefore will invest in a company practically forever—or as long as the company is part of the benchmark. So if we really like the stock of Company XYZ, for example, we can't buy more. If we don't like the stock, we can't sell out of it. That's why our voice and our vote are so important."

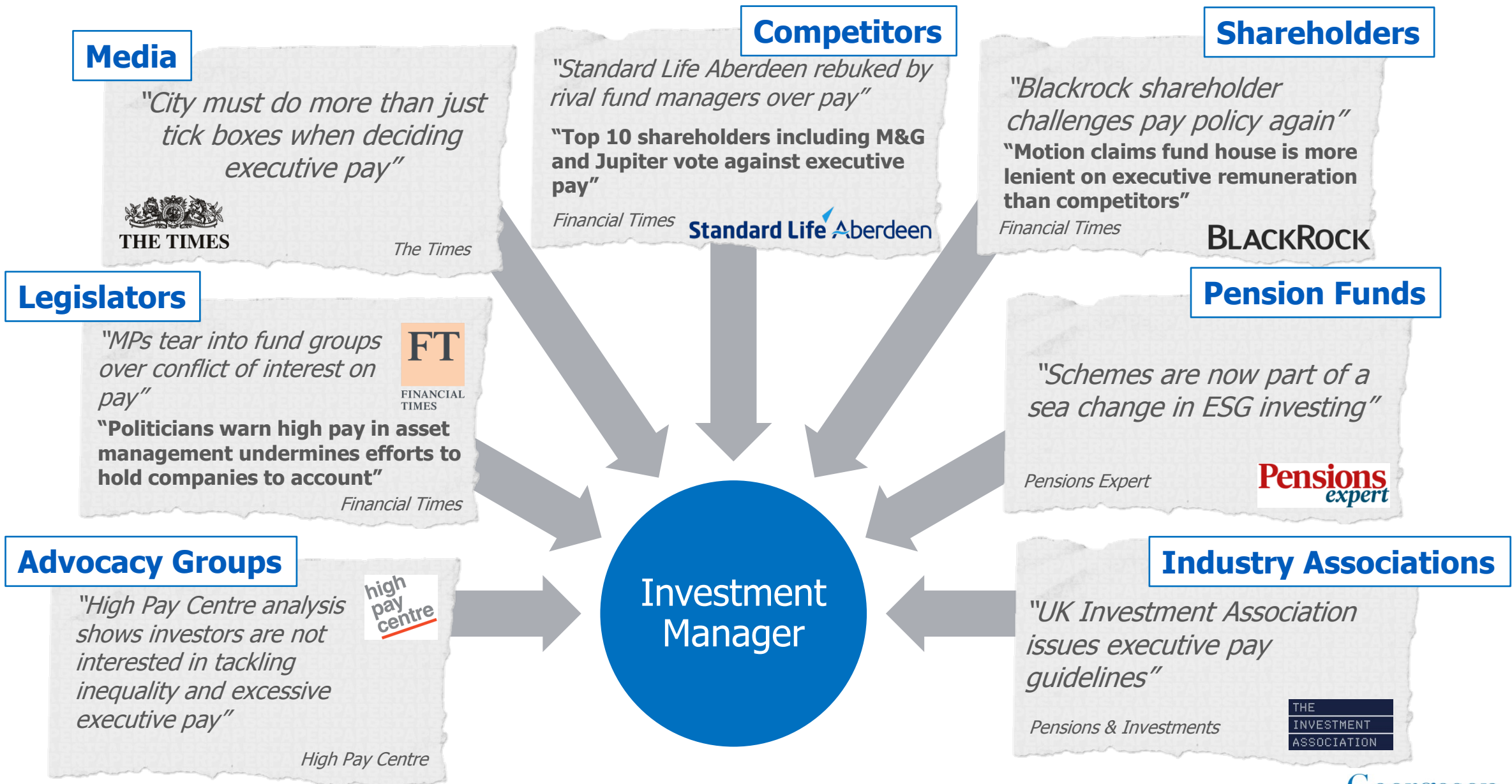


"We're riding in a car we can't get out of... governance is the seat belt and air bag."

Glenn Booraem
Investment Stewardship Officer
Vanguard

Investor Expectations

Examples – Investors under pressure



Investor Expectations

From Policy to Voting Decision

BLACKROCK®



BlackRock Investment Stewardship's approach to executive compensation

The following describes the beliefs and expectations of BlackRock Investment Stewardship (BIS) related to executive compensation practices, our Say on Pay analysis framework, and our typical approach to engagement and voting on Say on Pay. We provide our views on this issue in somewhat more detail than other issues covered in our various regional proxy voting guidelines because of the particular focus on executive compensation matters following the adoption of Say on Pay regulations in a number of markets. This approach is generally meant to be global in scope, although we acknowledge that Say on Pay and relevant disclosures are not applicable to every jurisdiction.

HOLDING COMPANIES ACCOUNTABLE



"[won't hesitate to] exercise our right to vote against incumbent directors or misaligned executive compensation" [at companies that aren't responsive].

Larry Fink
BlackRock Chairman and CEO

Bloomberg

Presseinformation

Deka schärft Abstimmungsrichtlinien für die HV-Saison 2019: neue Anforderungen an Vorstandsvergütung

14.01.2019

- ESG-Kriterien als Bestandteil der langfristigen variablen Vergütung
- Total Shareholder Return nicht einzige Leistungskennzahl der langfristigen Vergütung
- Verpflichtung zum Eigeninvestment der Vorstände
- Offenlegung von Zielen und deren Erreichungsgrad



BMO



"Incentive awards to executives should be clearly disclosed and include robust and stretching performance targets to reward strong performance and drive shareholder value over a sufficiently long period of time. Furthermore, severance payments should not exceed two year's pay. Larger severance packages should be subject to a separate shareholder approval."



"The compensation committee of the supervisory board has been completely non-independent long-term, and this proposal is the most appropriate resolution for shareholders to show their discontent against such practices in the German market context"

AXA INVESTMENT MANAGERS

"Remuneration Policy not aligned with long-term shareholder interests "

Proxy Advisors' European Guidelines (1/2)

ISS Guidelines on Remuneration

ISS evaluates a company's executives' and directors' compensation arrangements on the basis of the **ISS Global Principles on Executive and Director Compensation** which take into account **global corporate governance best practice**:

Provide shareholders with clear, comprehensive compensation disclosures

Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value

Avoid arrangements that risk "pay for failure"

Maintain an independent and effective compensation committee

Avoid inappropriate pay to non-executive directors

ISS' considers executive and non-executive director compensation on **different parameters**.

For **executive director pay**, the principles are spelled out as follows:

- > information and disclosure shall be complete and timely provided to shareholders;
- > short- and long-term variable pay shall be appropriate (not discretionary and balanced between the two elements)
- > there should be a clear link between pay and performance;
- > no executives on the compensation committee (which shall be majority independent)

For **non-executive director pay**, the fifth principle is spelled out as follows:

- > compensation shall not be excessive compared to peers
- > compensation shall not be performance based

Proxy Advisors' European Guidelines (2/2)

Glass Lewis Guidelines on Remuneration

Glass Lewis publishes **German-specific guidelines** that are meant to supplement their European guidelines. Glass Lewis evaluates a company's executives' and directors' compensation arrangements based on **different parameters**.

Management Board Remuneration

remuneration shall include a performance-based component

- > remuneration shall be tied to appropriate forward-looking multi-year targets
- > performance goals must be challenging
- > overall and individual remuneration components must have clearly disclosed caps

Glass Lewis assessment of a management board remuneration structure will focus especially on the **overall effects of any structural changes** as well as on any positive or negative change in the level of disclosure. In this respect, Glass Lewis will especially take into account the general "**direction of travel**" of a company in terms of remuneration structure and disclosure.

Different parameters are set for the evaluation of supervisory board members remuneration.

Supervisory Board Remuneration

- > NED remuneration shall not include performance-based components (or must be very limited)
- > Remuneration shall not include any variable fees depending solely on short-term profit-based metrics

Outlook 2020

How to prepare for a remuneration vote at your next AGM?

Identify what is market best practice

- › Understand what the company's peers are doing in relation to pay practices and identify global best practice standards.

Understanding the views of your investors

- › Identify who your investors are and who is making the voting decision on agenda items at the AGM.
- › Engage early in the process of designing a remuneration policy. This should be done in the form of a consultation (which is considered a best practice) where investors can influence the outcome and suggest actual changes to the policy.
- › The best time to start engaging with investors on changes in the remuneration policy is between September and December, prior to the AGM.

Engage with key perception influencers

- › It is important that the Company engages with and monitors the vote recommendations of proxy advisors.
- › A thorough analysis should be done whether the remuneration policy and remuneration report meets the guidelines and standards expected by the proxy advisors.
- › Large institutional investors have to vote a large number of meetings. These institutions use proxy advisors to help flag contentious meetings and there is a clear correlation between negative proxy advisor recommendations and lower vote results.

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