The Theory and Practice of Directors' Remuneration

New Challenges and Opportunities

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Emerald

Chapter 13 The European approach to regulation of director's remuneration

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1. Introduction

During the last ten years the European Commission has outlined a framework for the Community action to improve Company Laws and Corporate Governance practices in the European Union, to enhance, as a consequence, the real economy promoting efficiency and competitiveness of European companies worldwide as well as strengthening the shareholders rights and third parties protection. This review process, which started in 2003 with the "Action Plan for the Company Law Modernization and Corporate Governance Enhancing" and has accelerated in recent years. It was the result of the global economic and financial crisis and of the careful consideration on the factors which contributed to its occurrence which followed.

With regard to the problem of determining the remuneration of companies' directors, the European Community has agreed with the approach pointing out that the problem originates mainly on conflicts "principal-agent". These arise both: a) within public companies with widespread shareholders, between executive directors (agent) and shareholders as a whole (principal); b) within companies controlled by a limited number of shareholder, between controlling shareholders (agent) and other shareholders (principals).

The Commission noticed that in recent years, on one hand there have been an increasing relevance of the variable part of directors remuneration (i.e. linked to performance and responsibilities), but on the other hand there have been an orientation to short-term remuneration policies with a detriment of the results obtained in the long term. For these reasons, since 2004, the Commission has repeatedly tried to address the matter with three recommendations (Commission Recommendation 2004/913/EC, 2005/162/EC and 2009/385/EC) which addressed the following topics:

a) transparency regarding remuneration policies in general and remuneration of individual executive and not executive directors in particular;
b) shareholder vote on remuneration reports;

c) embed an independent remuneration committee and the provision of appropriate incentives to stimulate results and value creation in the long term.

Nevertheless, in 2010 and already before in 2007, Commission reports SEC (2007) 1022 and (2010) 285, the Commission had been able to see that certain Member States didn't adequately address the issues related to remuneration. For this reason in 2010 with the "Green Paper on corporate governance of financial institutions" consultation, the Commission returned on the theme by asking and obtaining clear indication about the need to refine directors' incentive structure, so as to encourage long-term results, sustainable for the company.

Most observers, however, opposed to the introduction of regulatory measures concerning the remuneration structure in listed companies, while others had favored the introduction of European rules to give greater transparency to the remuneration policies and to give shareholders a right to vote on these issues. As a result of this long debate, the Green Paper of the European Union in 2011 focused on two of the issues mentioned, namely:

a) making compulsory for companies the disclosures on remuneration policies adopted and on compensation attributed to executive and not executive directors;
b) requiring the shareholder vote on the remuneration policy.

In 2012 a further consultation on the future of European company law was undertaken.

The results of all these consultations led the Commission to publish, on 12 December 2012, the document "Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies», by which the European Commission wanted to expose the future lines of action to be pursued both in the area of corporate governance of listed companies and in corporate law. The main lines of action set out in the above Action Plan were:

a) to strengthen transparency;
b) to involve shareholders, in particular to encourage members to an active participation in corporate governance through enhanced monitoring by shareholders on remuneration policies and on transactions with related parties.

Particularly, the European Commission recognized the dangers of inadequate remuneration policies (too focused on short-term goals and not justified by the results achieved) and incentive structures in favor of directors that could lead to unjustified transfers of value in favor of the executive directors, with potential damage to the company, shareholders and other stakeholders. For this reason, the European Commission expressed the view that policies remuneration must be able to create long-term value, provide welfare for corporations and should therefore be based on a real connection between remuneration and achievements. In addition, a more efficient supervision by shareholders on remuneration policies adopted by the listed companies should be required as it could be part of the solution to the problem.

It emerged, therefore, the need to strengthen the transparency of remuneration policies and individual remuneration accorded to managers (principle of "say on pay"), as well as to recognize to shareholders a right to vote (to be established if binding on the directors or if purely consultative) regarding the remuneration policy adopted by the company as described in the remuneration report, which sets out the way in which this policy has been implemented in the previous year. With this initiative, the Commission also intended to remedy the problem of inconsistency between the disciplines of individual Member States relating to the right to vote on remuneration policy and/or the remuneration report, also in order to ensure the comparability of the information disclosed to the market by the companies in the different EU states.

On 9 April 2014, the European Commission published the Proposal for a Directive amending Directive 2007/36/EC as regards the encouragement of long-term shareholder and Directive 2013/34/EU regarding certain report elements on corporate governance. The primary goal of the proposed revision of the Directive was to contribute to the long-term sustainability of the EU companies, creating favorable conditions for shareholders. To improve the cross-border voting rights by increasing the efficiency of the equity investment chain in order to contribute to the growth, jobs creation and competitiveness in the EU. In particular, regarding the remuneration of directors, since in the current framework were found several weaknesses, the proposal aims to strengthen the correlation between directors remuneration and results, by strengthening shareholders monitoring. The document did not regulate the remuneration level, which is left to the decision of the companies and their shareholders. Articles 9bis and 9ter required listed companies to disclose detailed and easily accessible information regarding the remuneration policy and individual remuneration of directors and Article 9 ter authorizes the Commission to prescribe a standard of presentation of some of this information by an implementing act. As stated in the proposal all the benefits of the directors in any form must be considered in the remuneration policy and included in the report. These rules give to shareholders the right to approve the remuneration policy and to vote on the report on remuneration.

Therefore, the report favors the exercise of shareholders' rights and ensures the liability of directors.

2. Literature review

Directors' remuneration has been considered one of the central issues in the debate on the stability of financial markets as it concerns not only large financial institutions but all the companies which have recognized corporate governance relevance (Ferrarini, 2003; Baur, 2008; Bender, 2004; Fernandez Armesto, 2005; Bebchuck, 2004).

The different approaches developed in literature share some basic principles.

1. The principle of fair and reasonable remuneration. Compensation must be adequate to attract and retain top executives, but at the same time it needs to be defined in order to safeguard the interests of shareholders and stakeholders. Interests of managers can be not consistent with those of the company. Managers can pursue their own interests to the detriment of the others, committing the company in projects highly risky. This to raise their own power and possibly the value of their options in the short term.
2. The principle of transparency as an essential tool to monitor and to neutralize the bad tendencies of *compensation designers* who often try and make the amount of part of remuneration not clearly intelligible (the so-called camouflage mechanism).

In listed companies the two principles are particularly relevant for executives (directors and managers) for which the remuneration system is variable and linked to the performance (especially with plans stock options) (Santuosso 2010).

Best practices and regulatory codes in the different systems have provided rules to ensure greater transparency and increasingly precise mechanisms (such as annual remuneration reports). In addition, some rules have been introduced to better define and align the interests of managers with those of shareholders and stakeholders enriching and qualifying the bargaining process (internal and external to the company) to get free and balanced negotiations and a higher rate of agreements aligned to market conditions ("arm's length" bargaining). Most effective incentive plans have the characteristic that a significant part of the remuneration is related to the overall corporate performance (in terms of profitability for the shareholder-bondholder) with a focus on medium and long period. Short-term goals involve the risk of management myopia which drive to maximize current results reducing or even postponing policies (especially investment) that contribute the going concern and success of the company over time (Core, Guay, Larcker, 2003).

The basic requirement is to provide shareholders and independent directors, as well as non-executive directors, greater powers.

This is possible by: i) introducing rules to enhance the independence of the board increasing the number of independent directors and appointing a nomination committee and a remuneration committee, composed of non-executive and independent directors with powers of recommendations, proposals, advice; ii) requiring independent consultants to work out critical details of remuneration agreements; iii) asking for shareholders' meeting vote on executive relevant remuneration plans (Bhagat, Black,1999).

In many jurisdictions all these aspects are directly regulated by the law so that the economic rule is elevated to a legal provision. French Law (L.225-42-1, co.2, of the Code de Commerce) prohibits remuneration, for listed companies, not related to the performance. German law (87-1 AktG), requires that the supervisory board sets the total remuneration of the management board at an "appropriate" level, based also on performance and that the criteria for determining the fairness are linked to the tasks of each member of the board and benchmark considerations valuing the choices made by similar companies (Baums, 2001); it is not allowed to exceed the extend established except for specific reasons. In Italy negotiation takes place primarily between directors and shareholders: as a general rule remuneration is defined when directors are appointed or by shareholders' meeting (art. 2389, paragraph 1, Civil Code).

Despite the existence of regulatory frameworks distorting effects of the executive top management behavior persist and operations performed happen to affect the value and the stock prices of the company or its subsidiaries or parent. Literature is unanimous in considering this due to: a) the mismatch between the executive directors' interests and those of the stakeholders; b) the provision of plans acknowledging compensation disproportionately in favor of managers; c) the low efficiency of both the agreement mechanisms and the execution monitoring (Melis, Paper, Gaia, 2008).

In models based on performance (*equity-based pay models*) the selection of the performance indicator is complex and executive directors may cooperate to structure the remuneration components to their advantage suggesting indicators they are in the condition to manipulate (Cheffins, 2003). Similarly, in models based on simple options (*share-option-based pay*) managers influencing the structuring step can achieve greater benefits without any link to the company performance (Chance, Kumar, Todd, 2000).

Limits are also related to the governance "dysfunction". The board of directors - even with the presence of independent directors - is sometimes almost inactive as flattened and in owe of the executive directors. The reasons can be extremely varied, economic or not, from solidarity dynamics (collegiality, teamwork, desire to avoid conflict, sometimes friendship and loyalty) to real conflicts of interest, related to the influence that executives may have on the appointment of directors and on the renewal of their assignment (Brick, Palmon, Wald, 2006).

Many studies have been aimed at identifying reforms to better link compensation to performance and especially to try to strengthen the negotiating power of the shareholders to the power of the directors in order to balance the interests of different stakeholders involved.

In particular, the American doctrine suggested (Ferrarini, 2005):

- to use shares price as main performance index neutralizing market effects and sector influence and not recognizing special bonuses or privileges for not measurable effects of special operations (such as companies acquisitions);
- to reduce the so-called "windfalls" in equity based plans considering and neutralizing results obtained by chance and which cannot be considered as due to managers good performance;
- to keep all incentive mechanisms implemented by the company to create value, but modifying the payments timing (separating the assignment step from the payment step and distributing the second over a longer period of time), and avoiding all sort of "soft landing" mechanisms in case of management failures (the so-called golden parachutes).
- to ensure accountability and transparency, fairly reporting about any remuneration component (including deferred wages, retirement fund and consulting, stock option plans) in order to avoid any possible remuneration camouflage.

3. European approach to the regulation of directors' remuneration

Although the phenomenon in Europe has not reached the proportions observed in the United States, due to the different structure of the share ownership of the European companies, in recent decades, there has been an increasing use of different remuneration forms to motivate directors (M. Becht, Bolton P. and A. Roell, 2002).

The issue was therefore subsequently taken into consideration as part of the "Action Plan" drawn up by the European Commission in order to define the priorities of the harmonization process of the European company law (see: The Communication from the Commission "Modernizing company Law and corporate governance in the European Union. A plan to move forward", 21 May 2003, Com (284) 2003 final).

In particular, in this Plan, the Commission expressed the intention to start a process of homogenization of the various national legal provisions concerning the remuneration of listed companies' directors in regulated European markets. The Commission decided to opt in the first phase for the issuance of a recommendation, which is an act devoid of mandatory value for Member States but indicating the legislative policy goals that the Commission intends to promote and possibly pursue with ad hoc legislative measures, where possible by a spontaneous adaptation by member countries. The measure provided by the "Action Plan" concretely translated into two separate recommendations:

a) the first Recommendation, approved on 14 December 2004 (Recommendation 2004/913/EC, published in the Official Journal of the European Union of 29 December 2004. 153), which specifically regulated the remuneration of listed companies directors in regulated European markets;
b) the second Recommendation, adopted on 15 February 2005 (Recommendation 2005/ 162/EC, published in the Official Journal of the European Union of 25 February 2005), which regulated the role that "independent directors" should play in the corporate governance of listed companies.

3.1. Recommendation 2004/913/ec

The Community Recommendation 913/2004 is based on some statements already included in the previous 2003 document. It gives a range of proposals to strengthen shareholders' rights and modernize the board of directors. It provides for an initiative aimed at encouraging an appropriate regulatory regime for directors' remuneration in the Member States. It clears out that new regulation is necessary to avoid conflicts of interest and hence to implement appropriate governance controls, based on adequate information rights. Form, structure and level of directors' remuneration indeed are matters falling within the competence of companies and their shareholders, but it is also one of the key areas where executive directors may have a conflict of interest. It is important that listed companies display appropriate transparency in dealing with investors, so as to enable them to express their views.

In brief, the EC Recommendation is exclusively referred to the directors' remuneration of listed companies in regulated European markets. It invites the States to introduce by June 30, 2006:

a) a combined set of disclosure obligations intended to increase transparency for market and for shareholders especially with regard to the directors remuneration, possibly extending such measures to other components of the administration not part of the board, such as the general manager;
b) a specific commitment with regard to the remuneration through equity incentives.

More specifically, according to the first set of provisions, listed companies in regulated markets should draw up and publish (also on the website) on an annual basis a remuneration statement to be included in the annual report or separately, in which should be exposed the directors remuneration policy that the company intends to follow in the next year and in subsequent ones. The structure and consistency of the different remuneration components of individual directors (fixed fees, variable compensation in the form of bonuses or non-cash remuneration and even amounts paid by the company to administrators for other activities different from the one covered by the contract) should be disclosed. The information should be given also related to assignments carried out within the group to which the company belongs. The Recommendation then invites Member States to adopt specific legislative provisions to establish that, as already experienced in regulated US markets, share based remuneration may be adopted only after the shareholders' annual general meetings vote. The Commission suggests that the shareholders' approval should be imposed for each additional director's long-term incentives.

The Document is structured into four sections and the main guiding lines are the following:

Sections	
I ° Section	*Scope and definition*
II°Section	*Remuneration policy*
III° Section	*Remuneration of individual directors*
IV° Section	*Share-based remuneration*

Guiding Lines
Transparency and accountability generate investor confidence
Harmonized regulation contributes to eliminate unequal treatment
Shareholders need a clear vision of the remuneration policy
Remuneration policy should be part of the agenda of the annual general meeting giving shareholders an effective chance to express their views and an opportunity to debate
Remuneration policy will be better controlled if voted on by the shareholders;

the vote could be advisory
Disclosure of individual directors remuneration is important to appreciate it in the light of the overall performance of the company
Variable remuneration schemes (in shares, share options or any other right to acquire shares) should be subject to the prior approval of the general meeting

The following paragraphs summarize the main contents of each section and profile the ways guidelines are expected to get implemented by companies at the three different levels of disclosure: the general one, the individual one and the specific situation of share-based remuneration.

3.1.1 Remuneration policy

Disclosure is required. Companies have to draw up a special report of the remuneration policy named Remuneration Statement. It may be included in the annual report or in the notes to the annual accounts of the company and posted on the website. It must focus on policies for the following years and policies implemented in the previous year with particular emphasis on changes occurred.

The report must contain some main information:

1. Relative importance of the variable and non-variable components of the remuneration.
2. Performance criteria on which variable components of the remuneration are based.
3. Linkage between remuneration and performance.
4. Main parameters and rationale for annual bonus scheme and non-cash benefits .
5. Main characteristics of supplementary pensions or early retirement schemes.
6. Main terms of the contracts of executive directors especially with regard to duration, applicable notice periods, provisions for termination payments.
7. Information on the preparatory and decision making process used for determining the formulation of remuneration policies, as the composition of the Remuneration Committee, the role of external consultants whose services have been used in determination of the remuneration policy and the role of the shareholders' annual general meeting.

The EC Recommendation points out the relevance of shareholders' vote on directors remuneration:

the topic must be on the agenda of the shareholders' annual general meeting. The vote may be mandatory or advisory and member state may provide minimum quorum (at least 25% of those present or represented).

3.1.2. Remuneration of individual directors

The individual remuneration and other benefits should be the disclosed in the annual accounts or in the notes to the annual accounts or in the remuneration report. The main information which should be presented is:

- total amount of salary paid or due in the year;
- remuneration and advantages received from any undertaking belonging to the same group;
- remuneration paid in the form of profit sharing or bonus and the reasons for such compensation;
- additional remuneration for special services outside the scope of usual functions of a director;
- compensation paid to or receivable in connection with the activity termination during that financial year;
- total estimated value of non - cash benefits;
- the number of share options offered or share granted by the company during the relevant financial year and their conditions of application;
- the number of share options exercised during the relevant financial year and the price or the value in the share incentive scheme at the end of the financial year;
- the number of options unexercised and the main conditions for the exercise for the exercise of the rights;
- any change in the terms and conditions of existing share options occurring during the financial year;
- any change in the benefits accrue mechanism and retirement fund contributions

3.1.3 Share-based remuneration

All share-based remuneration mechanisms must be approved during the shareholders' annual general meeting. The approval relates to:

- grant of the share-based schemes, including share options, to directors;
- determination of their maximum number and main conditions of the granting;
- terms within which options can be exercised;
- conditions for any change in the exercise price options;
- any other incentive mechanism for which directors are eligible.

The annual general meeting should set the deadline within which the body responsible for directors' remuneration may award these types of compensation to individual directors. It is also required the assembly approval in case of discounted option arrangement under which any rights are granted to subscribe to shares at a price lower than the market value of the share on the date when price is determined or than the average of market values over a number of days preceding it.

Before the general assembly meeting shareholders must be adequately forewarned about the contents of the stock option plan and incentive. The costs of these operations must be disclosed. Similar information must be available on the company's web.

3.2. Recommendation 2005/162/ec

A second Recommendation was approved on February 15, 2005 and even if it concerns the role of nonexecutive or supervisory directors in the corporate governance of listed companies, it is also closely related to the remuneration topic. It gives indeed relevant suggestions about the organizational process that listed companies should follow to determine directors remuneration.

The presence of independent representatives on the board, capable of challenging the decisions of management, is widely considered as a means of protecting the interests of shareholders and other stakeholders. In companies with a dispersed ownership, the primary concern is how to make managers accountable to weak shareholders. In companies with controlling shareholders, the focus is more on how to make sure that the company will be run in a way that sufficiently takes into account the interests of minority shareholders. Ensuring adequate protection for third parties is relevant in both cases. Whatever the formal board structure of a company, the management function should therefore be subject to an effective and sufficiently independent supervisory function. Independence should be understood as the absence of any material conflict of interest. The supervisory role of non-executive or supervisory directors is commonly perceived as crucial in three areas, where the potential for conflict of interest of management is particularly high, especially when such matters are not a direct responsibility for shareholders: nomination of directors, remuneration of directors, and audit.

It is therefore appropriate to foster the role of nonexecutive or supervisory directors in these areas and to encourage the creation within the (supervisory) board of committees responsible respectively for nomination, remuneration and audit. Member States are invited to introduce a legislation that would require the establishment of the three committees within the board of directors (or the supervisory board in the dual system). As a general rule, therefore, the nomination, remuneration and audit committees should make recommendations aimed at preparing the decisions to be taken by the board. The primary purpose of the committees should be to increase the efficiency of the board by making sure that decisions are based on due consideration, and to help organize its work with a view to ensuring that the decisions it takes are free of material conflicts of interest. The creation of the committees is not intended, in principle, to remove the matters considered from the purview of the board itself, which remains fully responsible for the decisions taken in its field of competence

With regard to the Remuneration Committee, the Commission suggests (in the guidelines provided in Annex I) that it should be composed exclusively of nonexecutive directors who are not involved in the daily management of the company and that at least a majority of its members should be independent. Independence characteristics are highlighted in the same recommendation and guidelines contained in Annex II. The Committee makes proposals, for the approval of the board, on the remuneration policy for executive or managing directors. Such policy should address all forms of compensation, including in particular the fixed remuneration, performance-related remuneration schemes, pension arrangements, and termination payments. Proposals related to performance-related remuneration schemes should be accompanied with recommendations on the related objectives and evaluation criteria, with a view to properly aligning the pay of executive or managing directors with the long-term interests of the shareholders and the objectives set by the board for the company. The Committee should make proposals to the board on the individual remuneration to be attributed to executive or managing directors, ensuring that they are consistent with the remuneration policy adopted by the company and the evaluation of the performance of the directors concerned. In doing so, the Committee should be properly informed as to the total compensation obtained by the directors from other companies affiliated to the group. It is also asked to make proposals to the board on suitable forms of contract for executive or managing directors and to assist it in overseeing the process whereby the company complies with existing provisions regarding disclosure of remuneration-related items (in particular the remuneration policy applied and the individual remuneration attributed to directors). A special attention has to be given to the structure of remuneration for senior management monitoring both the level and the structure. And finally with respect to stock options and other share-based incentives which may be granted to directors, mangers or other employees, the Committee should debate the general policies, review information provided in the annual report and to the shareholders meeting and to make proposal concerning special choices concerning granting options.

The Recommendation specifies that the Remuneration Committee should be able to avail itself of consultants, with a view to obtaining the necessary information on market standards for remuneration systems. The Committee selects the consultants appoints them and should receive appropriate funding from the company to this effect.

4. Additional eu interventions

In March 2009 the Commission - with the Communication for the spring European Council, Driving European recovery - provided strategic guidelines to regulate and promote the best practices in implementing the two previous Recommendations (2004/913/EC and 2005/162/EC) and announced which would have been the further steps to be taken. Among these special attention was given to the remuneration of financial sector directors which resulted in London G20 commitments. The Commission presented its plan to restore and maintain a stable and reliable financial system. In particular, the Communication announced that a new Recommendation on remuneration in the financial services sector would be presented in order to improve risk management in financial firms and align pay incentives with sustainable performance.

The 30^{th} April 2009 the "EU Commission Recommendation on remuneration policies in the financial services sector" was delivered. It integrates the previous ones and contains some clarification agreed to give greater consistency to the principles set out with regard to remuneration policies orienting the containment of the financial risk and therefore addressed to the categories that carry out activities with major impact on business risk. The documents clears out that excessive risk-taking in the financial services industry and in particular in banks and investment firms has contributed to the failure of financial undertakings and to systemic problems in the Member States and globally. These problems have spread to the rest of the economy and led to high costs for society. Whilst not the main cause of the financial crisis that unfolded in 2007 and 2008, there is a wide-spread consensus that inappropriate remuneration practices in the financial services industry also induced excessive risk-taking and thus contributed to significant losses of major financial undertakings. Remuneration practices in a large part of the financial services industry have been running counter to effective and sound risk management. These practices tended to reward short-term profit and gave staff incentives to pursue unduly risky activities which provided higher income in the short term while exposing financial undertakings to higher potential losses in the longer term. Creating appropriate incentives within the remuneration system itself should reduce the burden on risk management and increase the likelihood that these systems become effective. Therefore, there is a need to establish principles on sound remuneration policies.

Again, in the same period (April 2009), the Committee of European Banking Supervisors (CEBS) published a set of 'High-level Principles for Remuneration Policies (Rem. HLP); the principles were intended to assist in remedying unsound remuneration policies. Whilst institutions' remuneration policies were not the direct cause of this crisis, their drawbacks, nonetheless, contributed to its gravity and scale. It was generally recognized that excessive remuneration in the financial sector fuelled a risk appetite that was disproportionate to the loss-absorption capacity of institutions and of the financial sector as a whole.

On 13 July 2009 the European Commission published a revision proposal of Directive 2006/48/EC and 2006/49/EC on capital requirements for credit institutions and investment firms (the Capital Requirements Directive, or "CRD"). The presentation of the proposal had been announced in the 30th April 2009 Communication, to complement the Commission's recommendations on remuneration policies in the financial services industry and on the directors remuneration of listed companies.

With the proposal adoption the Commission set the goal of:

a) make it mandatory for banks and investment firms to adopt remuneration policies that should be measured as a function of proper risk management of the financial institution and to be effectively aligned with the long-term interests of the entities ;
b) consider remuneration policies and their relationship with risk management subject to the supervision of the Authorities and provide the necessary tools to monitor the and punish those who adopt remuneration policies that encourage excessive risk-taking.

In particular, the Recommendation of 30th April 2009 completes the previous legislation and strengthens the remuneration policies with regard to the following aspects:

a) Principles and scope of application

The proposal applies to banks and investment firms authorized under Directive 2004/39/EC 8, having their legal head office or central administration in a Member State. As stipulated in the Recommendation for Financial Institutions, the principles on remuneration policy should be applied both by the parent company at the group level, both on individual companies within the group, including those established in offshore financial centers; moreover, Member States should ensure that branches of financial companies resident in a third country and operating in one Member State are subject to similar principles to those applicable to financial companies residing in the EU.

b) Structure and remuneration

The remuneration should be structured in order to ensure an appropriate balance between fixed and variable part. The fixed part must represent a sufficiently high proportion of total remuneration, such as to pursue a flexible policy on incentives and, where appropriate, not to pay any bonuses. Recommendation for Financial Institutions provides:

- the variable component should not exceed a fixed preconceived maximum amount;
- it should be enabled firms to withhold bonuses in case of economic deterioration circumstances;
- the adoption of negotiating forecasts that enable companies to ask their employees to refund, in whole or in part, the bonus paid on the basis of data subsequently proved "manifestly errors".

In case of a significant bonus amount, payment of the prominent part of the same should be deferred for an appropriate period of time and be subject to the achievement of further performance targets medium to long term. According to the Recommendation for Financial Institutions, the bonus amount to be deferred should be given in relation to the total bonus amount in turn, comparing to the total remuneration of the beneficiary. Recommendation for Financial Institutions also specifies that the payment of the deferred bonus part should: consider the risks associated with the achievement of results which the bonus is tied and could be liquidated in the form of shares, options or other financial instruments.

c) Parameters used for bonus calculation

The remuneration related to the achievement of performance targets should be calculated on the basis of results combination obtained from the single unit concerned, the bank or investment firm as a whole.

In identifying the parameters to be used to assess individual performance, Recommendation for Financial Institutions and the Principles suggest using, in addition to financial criteria, also non-financial criteria and/or qualitative, such as the level of compliance with the rules and internal procedures; this is the level of customer satisfaction. The current and future risks, the cost of capital used and liquidity related to the results achievement (and to the actual payment of bonuses) should also be considered in bonus calculation.

These results should be evaluated over a period of years in order to ensure that the assessment process is based on the long-term results of the company. For this purpose, both the Proposal, as far as the Recommendation for Financial Institutions, suggests an evaluation period of between 3 and 5 years.

d) Golden parachute

The amounts allocated in case of early dissolution of an employment contract, the so-called *golden parachute*, must reward goals achieved by employees during the employment period and not be seen as "reward for failure".

e) Decision-making and governance

The remuneration policy must be drowned up and approved by the board of directors (supervisory), which is responsible for the application of its principles. Recommendation for Financial Institutions suggests that, in the determination of the remuneration policy, the control authorities, the human resources department and external experts should be involved. In this sense, companies should make sure that the boards of directors members, the remuneration committee and staff, participating in the remuneration policy draft, have the "necessary skills" and are independent from the business units to which they are called upon to pronounce. The implementation of the remuneration policy should be subject (at least annually) to a central and independent internal review.

As specified in the Recommendation for Financial Institutions, the staff involved in the monitoring process should be independent from the controls operating units and should be adequately paid (independently from the results achieved from the company subject to control).

f) Transparency requirements and disclosures profile

The general principles of the remuneration policy should be formalized and accessible to all staff to which they apply. Staff should be informed in advance about the criteria that will be used to determine their remuneration. The evaluation process should be well documented and made available. Staff must also receive information regarding:

a. the decision-making process used for determining the remuneration policy, including, where appropriate, information on the composition and remuneration committee mandate, the external consultants and the role played by all parties involved;
b. the relationship between remuneration and performance;
c. the methods used for the results evaluation and the risk adjustment;
d. the criteria for performance evaluation on the basis of which is determined shares allocation, options or remuneration variable components;

e. the main parameters and the reasons related for the granting of any other bonus.

g) *Impact on the supervisory authorities powers*

Remuneration policies are under the monitoring of the supervisory authorities under the CRD. In order to ensure converging political control, CEBS should ensure on an ongoing basis the guidelines arrangements, including on remuneration. To the supervisory authorities, also in the remuneration matters, should be granted the power to adopt: restrictive measures, both qualitative (for example, may require banks and investment firms to reduce the risk inherent to their activities, products marketed by them, as well as in remuneration systems) and quantitative (for example could oblige some parties to hold more own funds to cover these risks); and/or financial and non-financial sanctions.

The European Parliament has subsequently occurred on remuneration of listed companies and remuneration policies in the financial services with the resolution of 7^{th} July 2010. It is related to the Commission Recommendation premise of 30^{th} April 2009 and with other provisions and proposals of International organization. The resolution, structured in 45 sections, highlights the importance of the following issues:

a) an effective remuneration governance that consider the opportunity of establishing a remuneration committee for financial institutions and listed companies, which should be independent, defines the remuneration policies, responds to shareholders and supervisors and works closely with the company risk Committee for the evaluation of the incentives provided by the remuneration system;
b) an effective conformity between remuneration and prudent risk because remuneration must be in proportion to the size, organization and complexity of the company as well as appropriate to all risk categories and the risks timeline;
c) a correct balance between fixed and variable remuneration, it is proposed that the variable remuneration is paid only if it is sustainable according to the financial situation, which is deferred over a period considered appropriate (reasonable) and that it should also be paid by other non-cash instruments;
d) an effective prudential supervision and involvement of the other parties involved, it is necessary that companies disclose clear, comprehensive and timely information about the remuneration policies adopted.

The European Commission has undertaken an important path for the modernization of company law and enhancing corporate governance thanks to the publication of the Green Paper on corporate governance in financial institutions and remuneration policies adopted in June 2010. In this first Paper the Commission had already announced plans to launch a wider reflection on the corporate governance of all listed companies. After only a year, the Commission on 5th April 2011 published a second Green Paper on the EU framework for corporate governance through which a consultation was launched aimed at identifying ways to improve and modernize the system of corporate governance of European listed companies. It was followed by a consultation process, which ended on 22nd July 2011. The results were "summarized" in a Feedback Statement dated 15th November 15 2011. Within the Green Paper, the European Commission has fundamentally identified three main subjects on which to start the consultation: a) the board; b) the shareholders; c) the comply or explain basis. In particular with reference to the remuneration policy the most part of participants to the consultation were in favor of the proposal to introduce an obligation to disclose information about the remuneration paid by the company to its managers, in order to balance the different national rules and, in this way, make it comparable to information provided by the companies of different Member States.

Many of the above considerations are subsequently integrated in Directive 2010/76 / EC of 24th November 2010 amending Directives 2006/48 /EC and 2006/49/EC. In particular, this Directive accentuate that the inadequate remuneration structures of some financial institutions has contributed to the bankruptcy of certain financial institutions and have caused systemic problems in the United States and in the world. To oppose the potentially disadvantageous effects of designed remuneration structures should be introduced remuneration policies that are consistent with the effective risk management.

A further consultation on the future of European company law was undertaken and brought on 12th December 2012 to the publication of the new "Action Plan: European company law and corporate governance-a modern legal framework to shareholders more engaged and sustainable companies". The Action Plan identifies three main lines of action:

a) Increasing transparency with regard to listed companies and institutional investors.

For this purpose, the Commission proposes the adoption of compulsory measures to:

- strengthen the commitment of information on the policies adopted, to ensure diversity within the Board and on the evaluation of non-financial risks through the Accounting Directives;
- allow the shareholders identification by the company at European level;
- introduce disciplinary reporting obligations about voting policies and activism of institutional investors, and the voting report.

b) Enhancing the active role of shareholders.

For this purpose, the Commission proposes to amend shareholders' rights to:

- strengthen the control of the shareholders on the directors' remuneration, providing the obligation of an assembly vote on remuneration policy and on the report that explains how the policy was implemented and the remuneration of individual directors;
- strengthen the oversight of transactions with related parties;
- introduce rules on the transparency of the advisors activity and conflicts of interest.

c) Supporting the growth and competitiveness of listed and unlisted companies.

The Commission aims to take the necessary measures to promote the freedom of the company and to create a legal framework for the creation of cross-border transactions.

On 26th June 2013, the Parliament and the Council have issued the Directive 2013/36/EU amending the previous Directive 2002/49/2002 and withdrawing Directives 2006/48/EC and 2006/49/EC. Directive 2013/36 / EU (CRD IV) gives large space to the remuneration policies of credit institutions and the supervision over them. The Directive goal is to encourage remuneration policies that are consistent with effective risk management. In conclusion it is advisable that institutions specify clearly the remuneration policies that they are aligned with the risk propensity, risk values and long-term interests of the institution. In determining the remuneration policy it should be considered the fixed and the variable component represented by monetary components that non-monetary. To avoid excessive risk-taking should be set a maximum ratio between fixed- and total variable remuneration. The provisions on remuneration should be reviewed periodically to a prudential containment of financial stability and not to threaten the shareholders' rights.

In 2014 the Commission has adopted further measures to improve the corporate governance of listed companies in particular, on 9th April 2014 was published the proposal for the revision of the Directive 2007/36/EC on the shareholders' rights.

With reference to the remuneration policies, for the first time at European level, it introduced the voting rights of shareholders on remuneration. The proposals commit companies to publish transparent information, comparable and comprehensive on their remuneration policies and implementing procedures. According to the European approach, it is not expected any constraint in relation to the maximum amount of wages, but each company is required to submit to binding vote of shareholders its remuneration policy, which should, however, set a ceiling on the directors' remuneration. The company is also expected to disclose about wages and working conditions of the employees, giving attention to the ratio employees' salaries-directors remuneration and discussing the long-term sustainability of the company remuneration policies in the context of the general company strategy.

5. Evidence on the actual compliance of the italian remuneration reports to the cg code.

In Italy the procedure for the implementation of European Directives on listed companies directors' remuneration began on 22nd December 2010 with the approval by the Council of Ministers of the Legislative Decree 259/2010. It implemented the recommendations of the European Community 2004/913 and 2009/385 and was enforced since 2012. In particular, the decree introduced art. 123ter TUIF which provides the publication on the company website of the report on remuneration policies and on the compensation at least 21 days before the shareholders meeting.

In 2011 was established the Corporate Governance Committee (hereinafter also the "Committee"), as result of an agreement between the promoters of the Corporate Governance Code (*Borsa Italiana, Abi, Ania, Assogestioni, Assonime and Confindustria*). The aim of the Committee was to ensure a continuous and structured process for both the implementation and the monitoring of the best practices adopted by Italian listed companies. Among the other issues, the Committee controls the implementation of art.6 of the Corporate Governance Code which deals with the remuneration issue, providing some recommendations, as for example, the definition of a variable component of the remuneration of executive directors (principle 6.P.2), the provision of a cap to the variable component of remuneration packages (criterion 6.C.1, let. b) as well as the recommendation concerning indemnities eventually set out by the issuer in case of early termination or non-renewal of directors (criterion 6.C.1, let. f). The Remuneration Report should provide at least information required by Consob in the Scheme no. 7-bis, Annex 3A of the Issuer Regulation which provides a scheme about the information to be provided in the Remuneration Report. That Scheme requires information to be provided, on an individual basis, in case of companies of "non -small" size, as defined by Consob Regulation no. 17221/2010, also for key management personnel in case their "total compensation (as a result of monetary remuneration and that one based on financial instruments, including also those received by subsidiaries and affiliated) exceeds the highest total compensation" paid to "members of the administrative or control corporate bodies or general managers". This happens rarely and it is generally related to "exit situations", when a subject hierarchically subordinate receives – exceptionally – a total remuneration which is higher than that paid to the top management of the company. The Remuneration Report is an extensive report, which provides a lot of information, both ex ante, on the policy adopted by the company, and ex-post, on the effectively paid remuneration.

In December 2014 Assonime has published the results of its annual survey about the compliance with the Italian corporate governance code. The 2014 analysis covers 230 Italian companies, listed on the Italian Stock Exchange on December 31st, 2013, who's Reports were available as of July 15th, 2014: the survey covers substantially the whole stock list.

It includes two monographic parts. The first one analyses – as in the previous year – the remuneration of directors and statutory auditors, while the second one focuses on the application of the comply-or-explain principle. The part dealing with remuneration of directors and statutory auditors is based on information drawn from the Remuneration Reports, which are made up of two sections: a first section, subject to a non-binding vote of the Annual General Meeting (AGM), describes the company remuneration policy as well as the procedures used for the adoption and the implementation of this policy. The second section provides information on the remuneration actually paid to directors, statutory auditors and general managers (as well as, on an aggregated basis, the remuneration of the key management personnel), distinguishing between remunerations paid by the company and those paid by subsidiaries or affiliated companies.

With specific reference to the "Remuneration Reports", even though there are still areas of improvement, information made available are many and significant. The first section of the Report provides information on the remuneration policy and the governance procedures. The policy may have a different level of detail and specification depending on the company and on the specific topic. In particular, not all companies have expressed a precise orientation with respect to each point provided in the regulatory scheme. A number of companies either communicates not to have made specific provisions relating to a specific point or state that the board "may" decide on a case by case basis.

1. Using benchmarks

The Scheme 7-bis of the Annex 3A to the Issuers Regulation (the so-called Consob Scheme) requires issuers to provide, in the first section of their Remuneration Reports, if the remuneration policy has been defined also with reference to the policies of other issuers and, if so, how this benchmark has been selected. 177 companies disclosed this information (i.e. 77% of the aggregate). Among those providing this kind of information, 68 companies (i.e. 30% of the aggregate) provide also information with respect to the criteria used to identify the benchmark companies (peers): or, however, companies considered as basis for comparison when fixing

Remunerations. Peers identification is instead quite uncommon: the name of the benchmark has been disclosed only by 13 companies (6 in 2013), i.e. 6% of the aggregate.

2. Consistency with the remuneration policy

The Consob Scheme requires issuers to provide, in the second section of their Remuneration Reports, an adequate representation of each item of the remuneration table, underlining the consistency with the policy of reference. The Remuneration Reports were analyzed looking for explicit information about the consistency of remunerations paid in 2013 and the policy "of reference", which is, usually, the remuneration policy approved by the Annual General Meeting (AGM) of the same year. The AGM vote is, as already mentioned, an advisory vote: the exceptions are companies in the financial sector, where the AGM should "approve" the remuneration policy. Information on this point has been provided by a small number of issuers: 74 companies, i.e. 32% of the aggregate (strongly increasing from 21% in 2013).

3. Policy Changes

The Consob Scheme requires issuers to provide, in the first section of their Remuneration Reports, the objectives pursued with the adopted remuneration policy, its principles and eventual changes of the policy compared to the previous year. In 38 cases (i.e. 17% of the aggregate, decreasing from 22% in 2013) Reports are explicitly disclosing that the remuneration policy has been changed with respect to the previous year (see. Tab. 24). The reduction is stronger among larger companies (from 34% to 19% of the aggregate among FTSE Mib) and, in particular, in the financial sector (from 44% to 17% of the aggregate).

4. Fixed and variable remuneration

The Code recommends that a significant part of the remuneration of managing directors and key management personnel shall be linked to the achievement of specific performance objectives, also no-economical ones, set out in advance and consistent with the remuneration policy's guidelines. The existence of a variable remuneration linked to business results is disclosed by 175 companies (i.e. 76% of cases: the figure is slightly increasing from 2013, when the percentage was equal to 74%). The frequency of such disclosure increases according to company's size (94% in FTSE Mib, 88% in Mid Cap, 71% in Small Cap). The existence of a relevant number of companies (medium-small) where no director receives a variable remuneration may be surprising.

5. Parameters

The Code makes various recommendations regarding the structure of the variable component. Inter alia, it is provided that: a) the fixed component and the variable component should be properly balanced; b) it should be set a ceiling for the variable component; c) performance goals should be predetermined, measurable and linked to the creation of value for shareholders over the medium-long run; d) the payment of a significant portion of the variable remuneration should be deferred for an appropriate period of time; e) compensations provided for early termination should not exceed a specified amount or a specified number of years of remuneration.

A description of the – predetermined – performance parameters, to which the variable remuneration is linked, is almost always provided. This is true in 167 cases (95% of the companies having a variable component for directors; 92% in 2013). Parameters' choice may be different; the reference to accounting indicators (EBITDA, EBIT, Profit, EVA, etc.) is largely prevailing: it can be found in 93% of cases. Way less common (42% of cases) is the reference to "business" targets. The presence of remuneration components related to shares' market value (stock-based compensation plans, usually options or allocation of shares, the latter often linked to the achievement of business results; more rarely phantom plans based on algorithms related to this value) is reported by 38% of companies; it is more frequent among larger companies (65% of FTSE Mib companies disclosing the presence of variable components). The adoption of stock-based compensation plans for directors is strongly decreasing (46% in 2013, 50% in 2012). In 126 cases (72% of the companies having a variable component) an indication of the relative weight of fixed and variable component is provided. Such information is more frequent in the financial sector (85% of cases); less frequently, but still in a pretty high percentage (70% of cases) in other industries. It is basically impossible to report aggregate statistics on the relative weight of the two components because this information is generally provided in a non-homogeneous form, depending on the different structure of incentive plans. In the 89% of cases companies communicate to have set a cap on the variable remuneration.

6. Short and medium-long term oriented variable components

The presence of incentive components – clearly separated – in the remuneration is very widespread: variable remunerations are generally linked to short term (Management-By-Objectives plans or MBO) or medium-long term performance targets (Long-Term Incentive Plans or LTIP). The CG Code recommends that the variable remuneration should be defined in such a way to pursue the creation of value for shareholders in the medium-long term, without any specific indication concerning the timing of the performance targets. A short term oriented variable remuneration has been observed in 156 cases (i.e. 89% of companies disclosing the presence of a variable remuneration; 82% in 2013). On the other hand, 131 companies disclosed the adoption of a long term based variable remuneration (i.e. 75% of the total, substantially increasing from 67% in 2013). Such a variable component is more frequent in the financial sector (80% of cases) and, above all, among larger companies: 94% of companies among FTSE Mib disclosed the presence of a long term based variable remuneration; the percentage drops to 80% among Mid Cap and to 65% for Small Cap).

7. Indemnities in case of resignation or dismissal

The existence of a cap for indemnities to directors in case of resignation or unfair dismissal is explicitly reported - in the Remuneration Report - in 57 cases, i.e. 25% of the aggregate, as recommended by the Code. It does not mean necessarily that each of these companies has already adopted an agreement on this point: in many cases, in fact, they have a policy which is going to be applied in the future, if and when specific agreements with directors and key managers will be signed. The frequency of such cap is much more frequent among FTSE Mib companies (47% of cases). Eventual caps are defined according to different parameters and, consequently, data are not easy to analyse on an aggregate basis. The most common situation is the settlement of the cap at two years of remuneration. However, we can also find companies where the cap is lower (for instance, 0.3 or 1 year of remuneration) or higher (for instance, 2.5 or 3 years of remuneration), up to a maximum of 6 years of remuneration. Companies are generally (even if sometimes not explicitly) referring to the global remuneration, including its variable component. On the other hand, some companies make explicitly reference only to the fixed remuneration, eventually linked to the RAL of the recipient. In some other cases, they disclose the payment of a fixed remuneration, of a more complex remuneration package, that includes a fixed component plus a component linked to the variable remuneration already received, or a "termination treatment" (trattamento di fine mandato, TFM) linked to the length of the mandate or the time prior to the natural termination of the mandate. Some companies underlined that the policy should be understood as the "main rule and would not apply in exceptional circumstances". Other companies declare that the

BoD "can" decide to provide these indemnities; others state that the payment of an indemnity is "generally not intended" (except from law prescriptions for directors that are also managers of the company). In such cases, the cap in obviously intended as 0.

8. Remuneration actually paid

Data on the level and structure of individual directors' remuneration were collected from section II of the Remuneration Report. As in the past, these data have been matched with information drawn from Corporate Governance Reports, in order to extract information about some relevant issues. The Scheme attached to the Issuers Regulation involves the preparation of very complex tables and often to the duplication of a number of information already provided in other parts of the Report. The average directors' remuneration amounts to 229,000 €. It varies greatly according to the size of the company (it is 403,000 € in the FTSE Mib, approximately 2.8 times more than the average remuneration in the Small Cap, amounting to 142,000 €). Variations over time are generally not significant.

Reports provide the number of directors who are beneficiaries of stock-based plans and of the fair value of such plans, measured using the conventional criterion of the "operating cost" - borne by the issuer - for the accrual year, pursuant to international financial reporting standards.

A very small number of directors (71 directors, i.e. 3% of the sample) receive equity compensation "expensed" in whole or in part, during the fiscal year of reference. The number of beneficiaries is almost stable over time (76 directors in 2013, i.e. 3.1% of the aggregate). These amounts are quite considerable (amounting to an average of 515,000 €, that is, more than 2 times the global cash remuneration). Frequency and amount of equity compensations vary according to the size of the company. Cross-checking data of remuneration with those concerning meetings attendance, we investigated the remuneration of the directors who did not take part in any meeting during the 2013. The goal was not to identify unjustified fees (commitment for meetings, as mentioned earlier, does not measure the actual commitment required to members of corporate bodies) but to stimulate a reflection on the most appropriate parameters for the commensuration of fees. It is thus observed that among the 15 (8 in 2013, 23 in 2012) directors that attended no meeting (10 of which due to appointments near to the end of the year), 1 did not receive any compensation. Other 13 directors have received a low remuneration (less than/equal to 10,000 €), possibly calculated in proportion to their time in office.

9. Remuneration and directors' role

The fees are significantly different depending on the role. The remuneration rank sees at the top MDs, who receive an average remuneration of 846,000 €, followed by executive chairmen, who receive about 25% less than MDs (645,000 €). The other executive directors receive a remuneration which is approximately a little less than 60% of MDs' remuneration (499,000 €). There are then non-executive chairmen (302,000 €) and deputy-chairmen (257,000 €). Even the following steps are quite sharp: non-executive members of executive committees receive on average 83,000 €. Other non-executive (76,000 €) and independent directors (54,000 €) stand at the bottom of the list. Both the amount of the remuneration and the structure of cash remuneration vary according to directors' role: the remuneration of a MD is made - on average - for the 55% of a fixed component, while bonuses account for 24% and remunerations from subsidiaries for 11% (other items account for smaller amounts). The remuneration of executive chairmen is composed of higher fixed components (68%), much lower bonuses (5%) and fees from subsidiaries generally comparable to those of the MD (11%). The remuneration structure of other executive directors is quite the same, even though they receive a lower fixed component (39%) and definitely higher compensations from subsidiaries (31%). Non-executive chairmen receive almost only fixed compensation (84% of the aggregate). Non-executive directors rarely receive bonuses and other incentives; when this happens, small amounts are involved. Non-executive directors (not independent), however, receive significant compensation from subsidiaries (23,000 €): the weight of this component (31% of the aggregate) is basically the same as for "other executives".

The remuneration of independent directors varies according to company size: among FTSE Mib companies the remuneration slightly exceeds 100,000 €; in Mid Cap companies is halved (51,000 €) and in Small Caps remuneration decreases by 40% (30,000 €). This trend reflects – probably – not only the different kind of problems affecting firms that belong to different index sections, but also a different depth in the application of the Code recommendations that require a specific commitment of independent directors. Global average remuneration of independent directors is stable over time. Independent directors basically perceive additional compensation only for their participation to committees and, however, for limited amounts (16,000 €, i.e. 29% of the aggregate). They never perceive equity compensation.

It may be interesting to analyze together data concerning both directors' age and compensation, distinguishing them by role. MDs and "other executives" are the youngest category (average age of 56 years). Followed by "other non-executives" and "other independents" (average age of respectively, 56.5 and 59 years). Directors belonging to other categories are generally older (62 years for deputy chairmen, 68 for non-executive chairmen, up to 71 for executive chairmen).

The survey by Assonime gives more analytical details but what is here relevant is the general positive conclusion that the Report express about the situation observed. The document points out, indeed, that the drafting of specific Remuneration Reports increased significantly the amount of information available to investors. The disclosure level is often a best practice one: there are not many countries where similar information is available on an individual basis (i.e., for each member of the administrative and control corporate bodies). This is especially true for the so-called ex post information (about the remuneration actually paid).

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