

By e-mail: executivepaydiscussionpaper@bis.gsi.gov.uk

Executive Pay Discussion Paper
Business Environment
Department of Business, Innovation and Skills (BIS)
1 Victoria Street
LONDON SW1H 0ET
UNITED KINGDOM

Amsterdam, 22 November 2011

Ref: B2011.60

Subject: Response to the BIS Discussion Paper on Executive Remuneration

Dear Sir/Madam,

We welcome the opportunity to submit a response to the BIS Discussion Paper on Executive Remuneration. By way of background, and to put our comments in context, Eumedion is the Dutch based corporate governance forum for institutional investors. Our 69 Dutch *and* non-Dutch participants – all with a long term return focus – have together more than EUR 1 trillion assets under management.¹ As our policy engagement is focused on new European-wide and Dutch legislative initiatives, and not on legislation of other, individual, EU Member States, we will refrain from commenting on the questions raised in the Discussion Paper. Therefore, we will confine our response to the sections in which Dutch legislation is mentioned, sections 66 and 90, and to our experiences with the binding vote on (amendments to) the remuneration policy of the management board of listed companies which have their statutory seat in the Netherlands and with the works council's right to present its opinion on the proposed remuneration policy.

¹ Eumedion endeavors to achieve better corporate governance by the following means: (i) facilitating of joint consultations between institutional investors and with listed companies and their representative organizations, (ii) providing service in the field of corporate governance to its participants and (iii) consultation with the national en European governmental en supervisory bodies.

1. The binding 'say on pay' vote in the Netherlands

1.1 Background

Since 1 October 2004, the general meeting of shareholders of Dutch listed companies has the right to adopt the remuneration policy for executives and the right to approve option and share schemes (Article 2:135 Dutch Civil Code). The proposed remuneration policy should at least contain information on the proposed policy regarding fixed salary, severance payments, pension payments and bonuses of executives. The vote is a binding vote. Within the boundaries of the adopted remuneration policy, the supervisory board has the power to determine the individual remuneration packages of the executives. The legal consequence of voting down a proposal to amend the remuneration policy is that the 'existing' policy will remain in place until a new remuneration policy has been adopted by the general meeting.

First objective of the legislation was to achieve a better governance structure for determining the remuneration of executives. The tasks of the management board, the supervisory board and the general meeting are clearly distinguished in Dutch corporate law. The management board manages the company; the supervisory board supervises and advises the management board, and the general meeting monitors both the management board and the supervisory board. Shareholders are not intended to act the part of members of the management board, or to act the part of the supervisory board members. The division of tasks is different, however, where the remuneration of management board members is concerned. The management board determines directly or indirectly the remuneration of all the other employees of the company, but it is obviously undesirable for the members of the management board to determine their own remuneration. As a consequence, supervisory board members have been given a more executive task with regard to the remuneration of the individual management board members under the articles of association, which means that the task of the general meeting has altered as well. In the case of the remuneration of the management board, the supervisory board initiates and implements the policy here and the general meeting monitors the way in which the supervisory board members do this. The legislator's objective was to explicit shape to this special role allocation with respect to the remuneration of members of the management board: the remuneration policy is adopted by the general meeting of shareholders and executed by the supervisory board i.e. determining the remuneration packages for individual members of the management board members within the borders of the remuneration policy as adopted by the general meeting. The supervisory board is responsible for the implementation and the results of this policy.

A second objective of the legislation was the prevention of excessive remuneration of

management board members. The Government thought that the general meeting of shareholders would only adopt a moderate remuneration policy for the management board.

1.2 The effects of the binding say on pay vote

A. Dialogue with shareholders

Especially after the 2008 general meeting of Royal Philips Electronics rejected the proposal to change the long term incentive plan, there is a growing willingness on the part of Dutch listed companies to actually enter into a dialogue with shareholders in advance of the shareholders' meeting, in order to provide shareholders with explanations of possible proposals to change the remuneration policy at an early stage, to learn of the initial views of the shareholders and to take these into account in the final proposal submitted to the shareholders' meeting. The threat of voting down remuneration proposals looks to be an uncomfortable burden for many listed companies and their supervisory board members.

The quality of the dialogue varies, however. A small number of companies involve their shareholders at a very early stage in order to find out what their specific issues are with regard to the existing company's remuneration policy, and subsequently return several times to present draft proposals for amendment to the policy and to hear the comments on these before the definitive proposal is finally presented at the shareholders' meeting. In contrast, however, there are also a number of companies that run through a complicated proposal for an amendment to the remuneration policy at breakneck speed in a very short session, following which shareholders are allowed a very short time to respond to the proposal, without the required documentation being left behind for further study. In this manner, dialogue becomes more of a formality or simple box-ticking in order to be able to state in the definitive proposal that the proposal is the result of an intensive consultation process with the most important shareholders. There is scarcely any question of a fruitful dialogue in such cases. The quality of the dialogue is largely determined by the length of the period within which shareholders can state their opinions on (draft) proposals and prompt commencement of consultation can prevent unnecessary polarisation shortly before or during a shareholders' meeting. None of this detracts from the fact, however, that a board must always make its own decisions on the final proposal presented to the shareholders' meeting. After all, boards should also weigh up other interests when considering a proposal than the shareholders' interest alone. Boards also bear ultimate responsibility for the proposal that is presented.

B. Change in composition of remuneration

Research² suggests that the composition changed significantly after the introduction of the binding say on pay vote, with more focus on variable compensation. The growth rate of cash compensation was significantly lower after the introduction. This is partially influenced by the economic conditions, but it also shows that the remuneration policies are more oriented at long term variable pay. Moreover, stock based compensation became more popular than stock options.

C. Correlation between executive total cash remuneration and company performance improved

According to a study of the Groningen University, conducted on behalf of the Dutch Corporate Governance Code Monitoring Committee, in November 2007 “The relation between the remuneration of executives of listed companies and the performance of these companies” (study only in Dutch), there is a positive correlation in the Netherlands between shareholder value and the level of the overall remuneration. The cash bonus reflects a positive correlation with turnover and profitability. The award of shares and stock options is closely related to the creation of (relative) shareholder value.

The study was, however, constrained by three limitations:

- The study looked at relationships between remuneration and four separate performance criteria. Combinations of different criteria in a single remuneration package – as often happens in practice – were not included.
- The study focused only on the question of whether performance influences remuneration. The question as to the reverse relationship, namely the influence of remuneration on performance, cannot be answered on the basis of this study.
- It is unclear how much time elapses between performance and remuneration. In the study, evidence was found for both simultaneous effects and for the effects of performance on remuneration in the following year.

2. Suggestion to introduce an employee vote on remuneration proposals

In question 7 of the Discussion Paper, the Department asks stakeholders to present their views on the costs and benefits of an employee vote (“endorsement vote”) on remuneration proposals. We do not feel that we are in a position to opine on this suggestion, but we would like to bring the Dutch system of employee involvement in approving (amendments to) the remuneration policy of the management board to your attention.

Since 1 July 2010, the works council of each Dutch listed company with a majority of its employees employed in the Netherlands has the statutory right to present its opinion on, inter alia, a (revised) remuneration policy to the shareholders’ meeting. The opinion of the works

² S. Halters, *Say-on-pay in The Netherlands, an extensive analysis of the effects*, January 2011 (Master Thesis).

council must be presented to the general meeting together with the proposal concerned (at least 42 days before the date of the general meeting). The works council should be given sufficient time prior to the date of the notice for a shareholders' meeting to define its position on the proposal concerned. At the shareholders' meeting the chair of the works council, or another member of the works council designated by him or her, is entitled to address the general meeting and explain the opinion of the works council. The general meeting of shareholders can take the works council's opinion into account in its decision-making process.

The 2011 proxy season was the first season that works councils were able to use this right. Therefore it is too early to present a complete evaluation, but our first impression is that in a majority of cases the works council used its right to give an opinion on the proposed amendments either before or at the general meeting of shareholders. In almost all cases the works council gave a positive opinion on the proposal; in only one case the opinion was "neutral". In some instances, it became clear from the explanatory notes to the agenda of the general meeting that the draft remuneration policy had been discussed "in detail" with the works council before it was sent to the general meeting. Apparently, the new works council's right stimulated communication between the (remuneration committee of the) supervisory board and the company's employees about the remuneration policy for the management board, which may have led to a better understanding of the policy. We are in general positive about the new works council's right, as the works council's opinion is information that can be taken into account in the voting decision-making process by shareholders, leading to an even more informed vote casting.

The clear role allocation with respect to executive remuneration is, however, preserved: only the general meeting of shareholders has the right to vote on a proposal for a(n amendment to the) remuneration policy; the works council's opinion can thereby be taken into account. It is the supervisory board's task to execute the remuneration policy a.o. by determining the remuneration packages of the individual members of the management board.

3. Suggested employee representation on boards of Dutch companies

In section 90 of the Discussion Paper it is suggested that Dutch legislation requires employees to be represented on company boards. We would like to underline that this is not the case. As it will be made clear below, it is even forbidden by law to have employees represented on supervisory boards of so-called structure companies.

Because of the apparent misunderstanding of the Dutch board system, we take the opportunity to explain the, rather complicated, appointment system of supervisory boards of so-called 'structure companies': companies that have at least 16 million euro share capital and at least 100 employees; however (international) companies that have a majority of employees employed

outside the Netherlands are exempted of the mandatory application. Of the largest listed ('AEX') companies 24% apply the structure regime; of the mid cap ('AMX') companies 38% have to apply the structure regime and of the smaller listed companies around 50%.

The works council of structure companies has a 'special' nomination right in respect of one-third of the seats on the supervisory board. Such a nomination is 'special' in that the supervisory board must accept it unless it has good reason to reject it, namely on the grounds that the 'special' nominee is likely to be unfit to perform the duties of a member of the supervisory board or that the appointment of the 'special' nominee would result in a supervisory board whose composition would no longer conform to the desired or required profile. If the works council and the supervisory board are unable to reach agreement on a 'special' nomination, the supervisory board should be able to ask the Enterprise Chamber of the Amsterdam Court of Appeal to rule whether its objection is justified on the grounds mentioned above. Ultimately, the members of the supervisory board are appointed by the general meeting of shareholders. The general meeting of shareholders is free to refuse the 'special' nominee of the works council.

It is important to note that any employee of the company (or any of its subsidiaries), or any employee of an employee organisation engaged in drawing up the working conditions of the company (or any of its subsidiaries) is not eligible for appointment to the supervisory board. Thus, it is even forbidden by law to have employees represented on supervisory boards of structure companies.

Companies that are not required to apply the 'structure regime' do not have special nomination rights for the works council. In these companies, it is common that the supervisory board nominates new candidates to be appointed by the general meeting of shareholders. None of these companies have employee representatives in the board. Moreover, for a supervisory board of a Dutch listed company, the independence criteria of the Dutch corporate governance code apply. One of the independence criteria is that a member of the supervisory board should not have been an employee [...] of the company in the five years prior to the appointment.

If you would like to discuss the current situation in the Netherlands in further detail, please do not hesitate to contact us.

Yours sincerely,



Rients Abma,
Executive Director Eumedion