POSITION ON
THE PROPOSAL FOR A DIRECTIVE ON SHAREHOLDER ENGAGEMENT
COM (2014) 213

1. General

Eumedion fully endorses the overarching objectives of the proposed directive:

(i) to contribute to the sustainable value creation of European companies,

(ii) to create an attractive climate for shareholders, and

(iii) to enhance cross-border voting.[1]

By means of the proposed directive, the European Commission is explicitly acknowledging and supporting the position that effective shareholder engagement is a basic element for good governance and the performance of listed companies.

Engaged share-ownership can provide a counterweight to harmful short-termism in connection with listed companies. [2] The responsible and efficient exercise of the voting rights attached to the shares reinforces the checks and balances within listed companies, which is crucial for the creation of long-term value for the company and all its stakeholders, including shareholders.[3] Engaged and responsible share-ownership is the prime focus of the individual and collective efforts of the institutional investors who are members of Eumedion, all of whom have a long-term investment horizon.

Consideration for long-term performance and growth opportunities for listed companies and their engaged shareholders is not only desirable, but necessary as well. The number of listed companies in Europe is falling on a long-term basis.[4] The Dutch public equity market with

[1] Explanatory Memorandum, p. 2.
[2] See considerations 2 and 8 of the proposed directive and elsewhere.
[3] Also see paragraph 1.1 of Eumedion Best Practices for Engaged Shareholdership.
[4] Weild, D., E. Kim and L. Newport (2013), "Making Stock Markets Work to Support Economic Growth; Implications for Governments, Regulators, Stock exchanges, Corporate Issuers and their Investors", *OECD Corporate Governance Working Papers,* no. 10, OECD Publishing.

scarcely 100 companies at present is decidedly no exception to this.[5] Regulated equity markets appear not to be sufficiently accessible and attractive at the moment for (potential) small and medium-sized enterprises to attract new equity capital. The European Union and its Member States could do more to create bigger and more liquid stock markets, as Eumedion recently pointed out in its response to the Communication from the Commission to the Council and the European Parliament on long-term financing of the European economy.[6]

Important parallels can be drawn between the long-term investment horizon of institutional investors and the long-term interests of listed companies, although these are not synonymous. The long-term interest of a listed company focuses on the sustainable success of the company and its stakeholders, while the long-term investment horizon of institutional investors is related to the management of the *whole* investment portfolio (all asset classes) in such a way that institutional investors can continue to permanently fulfil their obligations to their clients or ultimate beneficiaries. An institutional investor can come into conflict with his (fiduciary) responsibility for example, if he continues to hold an equity interest in a listed company while the market valuation of the share is higher than the institutional investor himself allocates to the share, or the company's strategy is not (no longer) in line with the investment strategy of the institutional investor.[7]

Engaged share-ownership, which is an expression of a long-term investment strategy in the equities component of the portfolio, does not automatically mean, therefore, that a shareholding in a specific listed company is held for a long time. Yet it involves that the shareholder is prepared to really take a more in-depth interest in the company for the duration of his share-ownership and to focus on the long-term value creation at the company and on the prevention of harmful short-termism when using the voting rights. We hope and anticipate that the proposed directive will mean that more institutional investors with a long-term investment horizon will be able to and will actually practice engaged share-ownership more seriously than is presently the case.

<u>General point for attention 1</u>

Some elements of the proposed directive deserve to be *strengthened;* these include the following:

i. The proposed provisions on shareholder identification (draft article 3a) should be extended to entitle a shareholder to request the listed company to forward information on a subject placed on the agenda for a shareholders' meeting (AGM) to other identified shareholders.

[5] Bootsma, B. and S. Hijink, "De beurs-nv in den vreemde", *IvO/ICFG Working Papers*, no. 2014/01.
[6] COM(2014) 168.
[7] See the Eumedion position paper of 12 March 2010 on engaged shareholdership (http://www.eumedion.nl/en/public/knowledgenetwork/position-papers/2010-position_paper_engaged_shareholdership.pdf)

ii. It should be patently clear that facilitation of the exercise of shareholder rights (draft article 3c) should apply to the whole of the chain (all intermediaries) between the listed company and the shareholders.

General point for attention 2

We have major *reservations* concerning a few elements of the proposed directive:

i. Sub-aspects of the transparency provisions for institutional investors and asset managers (draft articles 3g and 3h).
ii. Shareholders who, in the context of the proposed approval procedure of the remuneration policy, would also agree to the ratio proposed by the company between the average executive remuneration and the average remuneration of full-time employees of the company who are not executives (draft article 9a).

2. Definitions (draft article 1)

Eumedion has questions and comments regarding a number of definitions in the proposed directive:

Intermediary (subparagraph d): Not all links in the voting chain fall under this definition. Proxy solicitors (e.g. Georgeson), voting facilitators (e.g. Broadridge), proxy advisory firms (e.g. ISS and Glass Lewis) and civil-law notaries do not maintain securities accounts, but may well play an important role in the functioning of the international voting chain. It may not be necessary to bring all these parties under the definition, if it can be ensured by other means that they too must (jointly) implement the proposals to enhance the exercise of shareholder rights. See our comments on draft article 3c in this context.

Institutional investor (subparagraph f): The European Commission's reasons for choosing precisely the proposed framework are not completely clear to Eumedion. It is notable, for example, that investment firms and undertakings for the collective investment of transferable securities (UCITS) are not considered to be institutional investors, but only asset managers (subparagraph g). They are, however, held to be institutional investors in the definitions of this term based on the Dutch Corporate Governance Code and section 1 of the Netherlands Financial Supervision Act (Wft). One of the consequences of this is that an investment firm that has outsourced (a volume of) its investments to an asset manager is not entitled to the information that asset managers must disclose to their institutional clients pursuant to draft article 3h.

Asset manager (subparagraph g): Managers at investment firms that are exempted from the AIFM Directive, including the intra-group managers, fall outside the definition of an asset manager.[8] Eumedion wonders whether this is desirable under all circumstances. When the intra-group client of the exempted manager does in fact qualify as an institutional investor, it may be in

[8] Article 3 of the AIFM Directive.

the interest of his (institutional) clients if the manager were actually to observe the transparency requirements in draft articles 3f and 3h.

Shareholder engagement (subparagraph h): In a certain sense, engaged share-ownership refers to an approach developed by institutional investors and companies through time to give substance to holding a share and the attached control rights in a certain way. This potentially comprehensive philosophy of engaged share-ownership did not arise primarily from the law, which is part of the reason why it is also difficult to capture in a definition. This also means that the definition given in the proposed directive seems incomplete. The submission of a request for a subject to be placed on the agenda for an AGM for example, can be regarded as an act of engaged share-ownership under certain circumstances.

Proxy advisor (subparagraph i): Eumedion believes that the definition of proxy adviser or rather proxy advisory firms is correct in principle and more appropriate, moreover, than the rather vague term "*providers of shareholder voting research & analysis"* used by the proxy advisory sector itself in its best practice principles published on 5 March 2014.[9]

Long-term: the expressions "*long-term performance"* and "*medium to long-term performance"* are used in various parts of the proposal, but their precise meaning is not made completely clear in the proposed directive. Eumedion regards a focus on *long-term performance* as being that which does not lead to harmful short-termism: the overvaluing of short term effects and the undervaluing of events in the long term.[10]

3. Identification of shareholders (draft article 3a)

Eumedion is basically in agreement with the introduction of uniform European regulations for the identification of shareholders. This would offer significant advantages over having a variety of national regulations that are, by their nature, much more limited in scope. We nevertheless believe that a number of points in the regulations require amendment.

- In accordance with section 49b paragraph 1 of the Dutch Security Depositary Act (hereafter Wge), the identification regulations should be limited to those shareholders who hold at least 0.5% of the issued capital. This means it is still possible to identify the most important investors in the interest of good communication with these investors[11], without breaching the privacy of the small, mostly private, investors.
- Shareholders too should be entitled to use the details of the identified other shareholders in order to facilitate the exchange of information between shareholders in connection with subjects to be discussed at the AGM. The existing section 49c Wge provides an outstanding framework for amending draft article 3a of the proposed directive.

[9] http://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf
[10] Derived from J.M. de Jongh (2014), *Tussen societas en universitas; De beursvennootschap en haar aandeelhouders in historisch perspectief*, published by the Instituut voor Ondernemingsrecht, no. 94, p. 500 and other sources.
[11] Consideration 4 of the proposed directive.

- In contrast to section 49b Wge, the proposed directive scarcely provides for legal safeguards for the confidentiality of the details of the identified shareholders, apart from the requirement that the information be destroyed after 24 months. We request the European Council and the European Parliament to ensure that the safeguards are extended.
- It is stipulated in the second sentence of paragraph 3, that “this information may only be used for the purpose of facilitation of the exercise of the rights of shareholders”. Eumedion wonders how the identification of shareholders by a listed company could facilitate shareholders in the exercise of their control rights. The existing article 5 of the directive and draft article 3c of the proposed directive would appear to offer many more safeguards for the facilitation of the exercise of control rights.
- It is not clear to Eumedion why the right to rectify or erase incomplete or inaccurate data referred to in paragraph 3 should be limited to natural persons. Eumedion requests the Council and the Parliament to ensure that this right is extended to legal persons as well.
- In order to prevent excessive use of the identification regulations, a maximum should be stipulated for the number of times that a listed company may submit an identification request. It could be decided for example, to limit identification solely to the period between the convocation date and the date of the AGM, as is stipulated in the existing section 49b Wge.
- The regulations do not guarantee that the costs of identification remain within bounds. It is to the advantage of listed companies and shareholders alike that the relevant intermediaries in the chain do not charge high commercial prices for the provision of their services under the identification regulations, which does not serve the interests of good communication between listed companies and their engaged shareholders. In view of the dependency of the intermediary chain, it would be opportune if the proposed directive were to include effective provisions to prevent intermediaries from requiring disproportionate payment. Inspiration for this could be derived from the European directives on networks for telecommunications, railways and energy, where service providers and their customers are also dependent on the cooperation of a specified infrastructure manager. The existing draft article 3d offers insufficient safeguards in that respect.
- It is not clear to Eumedion who is charged with supervision of the correct implementation of the identification regulations. Eumedion would basically have no objections if the European Securities and Markets Authority (ESMA) and national regulatory authorities were given powers to implement this supervision.

4. Transmission of information (draft article 3b)

Eumedion has the following comments on the draft article dealing with the transmission of information.

- In order to facilitate effective and sustainable share-ownership, listed companies should be prepared to exchange ideas directly with their shareholders. This is common practice in the Netherlands and various other European markets[12] and this important principle deserves to be added to the proposed directive.
- In the light of the principle referred to under the previous bullet, the first sentence of paragraph 1 appears somewhat unfortunate: "Members States shall ensure that if a company chooses not to directly communicate with its shareholders,…".
- The coherence between paragraphs 1 and 2 of draft article 3b and the existing article 5 of the shareholder rights directive (which also applies to the provision of information in order to facilitate the exercise of control rights) does not seem completely clear. Information that is needed for the exercise of shareholder rights should, without exception, also be made available via the listed company's website.

5. Facilitation of the exercise of shareholder rights (draft article 3c)

From Eumedion's point of view, this is possibly the most fundamental draft article in the proposed directive. Shareholders who must cast their votes via proxy and often cross-border as well continue to be confronted with practical and legal problems, despite the development of information technology. Institutional investors have been waiting for appropriate legal regulations since the appearance of the report of the Expert Group on Cross-Border Voting in Europe (12 years ago).[13] Completely in keeping with the terminology of the proposed directive, it does not seem an exaggeration to identify this as *long-term failure*. The vested interests of the intermediary banks have certainly not expedited the matter, as M.C. Schouten has demonstrated in his doctoral thesis and E. Micheler has described in a recent paper.[14] Although it is most certainly in the interests of their direct or indirect client securities account holders that effective use can be made of the rights attaching to shares (the 'client centricity' adage), E. Micheler makes it clear that this is not the case: "*custody chains have become independent from investors and issuers. Neither issuers nor investors are able to control the length of the chain or the content of the legal arrangements that govern the custody chain. Custodians are connected through a series of bilateral links that are independent of each other. This erodes the rights of investors"*.[15]

The question that has to be asked is how an institutional investor can seriously implement engaged share-ownership, if even the mere basic exercise of voting rights is difficult.

[12] See the preamble to the Dutch Corporate Governance Code, paragraph 4.
[13] The report of the Expert Group on Cross-Border Voting in Europe dates from 2002 (https://english.wodc.nl/images/on2002-6-full-text_tcm45-57609.pdf).
[14] Schouten M.C. (2012), *The Decoupling of Voting and Economic Ownership*, publication of the Instituut voor Ondernemingsrecht, no. 88, p. 177 ff. and E. Micheler (2014), "Custody Chains and Remoteness - Disconnecting Investors from Issuers", *London School of Economics Working Paper*, can be downloaded at www.ssrn.com.
[15] Micheler, E. (2014), op. cit., p. 2.

In any case, a number of components of draft article 3c definitely require explication and reinforcement, if truly effective regulations are to be provided.

- It should be explicitly stipulated in paragraph 1 that the regulations relate to all intermediaries in the chain and not only to "*the intermediary*".
- It should be explicitly stipulated that when the intermediary engages a third party (such as a proxy facilitator), the intermediary remains responsible for the implementation of the obligation to facilitate the exercise of control rights.
- In line with the period referred to in article 14 paragraph 2 of the shareholder rights directive, the very welcome vote confirmation referred to in paragraph 2 should take place within 15 days of the shareholder meeting being held.
- It should be explicitly stipulated that the facilitation of the exercise of control rights is a "custodyship service" in the meaning of Appendix II of MiFID (ancillary services). This is extremely important, not only because the investor protection provisions of MiFID (article 19 in particular) apply to ancillary services, but also because this guarantees that supervision of the obligation to cooperate is carried out under public law by national regulatory authorities.
- In view of the nature of the subject matter, we would prefer ESMA to be authorized to work out the obligation to facilitate in more detail in Technical Standards. We believe this is preferable to the authorisation being allocated to the European Commission on the intercession of the European Securities Committee, as is proposed in paragraph 3 of draft article 3c.

6. Transparency on costs (draft article 3d)

In addition to the above comments in connection with the costs of identification, Eumedion would like to draw your attention to the following with regard to draft article 3d concerning transparency on costs.

- Apart from transparency on costs, it is of particular importance that the costs are not unreasonably high. Eumedion wonders whether sufficient safeguards have been provided in this respect by stipulating generally that the costs must be non-discriminatory and proportional, as referred to in paragraph 2 of draft article 3d. As M.C. Schouten states in his doctoral thesis, the costs in cross-border situations are one of the most important impediments to investors in casting their votes.[16]
- It would be unacceptable if intermediaries were to make a distinction between domestic and cross-border services when levying charges, as proposed in the second sentence of paragraph 2 of draft article 3d. If we look at the Dutch market alone, it is estimated that 86% of the shares are held by international institutions. Shareholders, and listed companies as well we presume, are not in favour of roaming-like excesses such as those that European citizens and companies

[16] Schouten, M.C. (2012), op. cit., p. 175.

have had to contend with for years in connection with forms of mobile telecommunication in cross-border situations.

7. Engagement policy (draft article 3f)

Eumedion supports the proposed provision that institutional investors be required to draft an engagement policy. Engaged share-ownership should be based on a pre-determined and well-considered policy. Paragraph 4 of draft article 3f already provides institutional investors and asset managers with the required flexibility. We have the following comments, however.

- The transparency provision applies to institutional investors and (their) asset managers. When an asset manager observes the same engagement policy as his institutional client(s), which would in itself be in line with the objective of the proposed directive, this may lead to double publication. The last situation would not be very transparent and be unnecessarily burdensome.
- The engagement policies implemented by asset managers may vary for each fund managed or asset management mandate. It is not proportional, therefore, and also not very informative to disclose all those different variants.
- It is important to clarify the cohesion with other existing provisions in European legislation that impinge on engagement policies observed by categories of institutional investors. The UCITS and the AIFMD regimes for example, already contain provisions for the development of voting policies by managers of investment firms.[17]
- Eumedion is concerned about the requirement that the results of the engagement policy be publicly disclosed (paragraph 3). The expectations of this disclosure requirement may be too high. In the first place, it is sometimes very difficult to establish the result of an engagement policy. When a listed company decides to amend its policy on the use of certain suppliers for instance, this may be the result of meetings with engaged shareholders, but the company's management may also have had different reasons or their own motives. After all, the policy (and its amendment) remain the responsibility of the board of directors. Furthermore, publicity about (alleged) results of engaged share-ownership may actually impair the effectiveness of engaged share-ownership.
- Eumedion is not in favour of the requirement to provide an "explanation" of voting behaviour in addition to transparency on the voting behaviour itself (paragraph 3, third sentence). If every vote cast has to be explained, voting and engaged share-ownership will become exceptionally time-consuming and expensive activities. It should be noted that the Eumedion

[17] See article 21 of Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company (PbEU L 174) and article 37 of Commission delegated regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (PbEU L 83).

best practices for engaged share-ownership stipulate that Eumedion members will, *if requested*, explain their motives for casting a vote against a proposal.[18]

8. Disclosure requirements for institutional investors (draft article 3g)

Eumedion shares the view of the European Commission that the content, effect and method of evaluating mandates given by institutional investors to their asset managers have a potentially major effect on the effectiveness of long-term engaged share-ownership and, by extension, on the role played by shareholders in the governance of listed companies.

It must be realised at the same time that the relationship between institutional investors and their asset managers is basically governed by contract law. Both parties are able to make provisions in the investment mandate for the adequate alignment of their (long-term) interests and statutory obligations. In addition, the mandate relationship between the institutional investor and the asset manager is subject to sectoral, national and European legislation and supervision is carried out by prudential and market conduct regulators. Investments by pension funds for example, are subject to what is known as the prudent person rule.[19] Life insurers must design their investment strategy in such a way that the obligations entered into and the technical facilities are such that these are fully covered by assets.[20] Pension funds and life insurers are also subject to rules with regard to the outsourcing of activities, compliance with which rules is also subject to supervision by public regulatory authorities.[21] The International Corporate Governance Network (ICGN) has also drafted a model for contracts between asset owners and asset managers, in order to achieve fuller alignment between their mutual interests. This gives rise to the question whether draft articles 3g and 3h are necessary in all respects and what the precise cohesion is with existing provisions.

Furthermore, Eumedion has the following comments.

- Public information on the methods and time horizons of evaluation may be competitively sensitive, specifically for the asset manager in question (paragraph 2, sub paragraph c).
- The above-mentioned distinction between the (fiduciary) responsibility of an institutional investor to invest in such a way that he can permanently meet his obligations with respect to ultimate beneficiaries (correct balance between assets and liabilities) and the long-term interests of investee companies, does not appear to be sufficiently expressed in the first sentence of paragraph 1. There are important parallels between the two guiding principles and they are not easily in opposition to each other, but they are not identical either.

[18] Best practice 7 of Eumedion Best Practices for Engaged Share-ownership.
[19] Art. 18 IORP Directive and section 135 Pensions Act (NL).
[20] 3:67 Financial Supervision Act (NL) and section 122 ff. Prudential rules (Financial Supervision Act) Decree.
[21] Section 34 Pensions Act (NL) and section 27 ff. Prudential Rules (Financial Supervision Act) Decree.

- How should the provisions be implemented in the event that the institutional investor has engaged a number of asset managers on the basis of several mandates, due to risk diversification for example, or the volume of the assets managed?
- Paragraph 2, subparagraph e, should be deleted. As has clearly been shown by research into the duration and turnover of Dutch equities published by the University of Tilburg in December 2012, portfolio turnover and turnover range are by far not the decisive factors for a long-term focus of institutional investors.[22] An institutional investor can hold his shares in a listed company for a very long time, while simultaneously also having a relatively high turnover in a small part of the equity position per company.
- In paragraph 2, subparagraph c, long-term absolute performance and performance relative to a benchmark index are positioned as opposing factors, which seems something of an oversimplification. Subparagraphs c and f of paragraph 2 appear to partly overlap each other incidentally.

9. Transparency of asset managers (draft article 3h)

Eumedion would like to make the following comments on the proposed transparency for asset managers.

- On the grounds of existing European legislation, asset managers too already have obligations, the objective of which is to serve the interests of their (institutional) clients as well as possible.[23] Transparency obligations with respect to clients also exist in European law to a certain extent.[24] This gives rise to the question of what the exact added value of draft article 3h is, what the cohesion is between the draft article and existing legislation, and whether the shareholder rights directive is the most appropriate place to include the transparency provisions.
- The obligation to render account for performance on a semi-annual basis, as proposed in paragraph 1, does not fit well into the current 'accountability cycle' of an asset manager. We prefer annual accountability.
- It is not clear how the accountability obligation in paragraph 1 must be interpreted in situations in which an institutional investor, who has himself been contracted as an asset manager, engages a (sub) asset manager to manage (parts of) the portfolio. This is a situation that frequently occurs in practice.
- It is equally unclear how a manager of a (collective) investment fund with various participants - who may have divergent investment strategies and horizons - could render account in the

[22] http://www.eumedion.nl/nl/public/kennisbank/publicaties/2012_research_report_duration_and_turnover_dutch_equities.pdf.
[23] Art.19 MiFID, art. 12 AIFM Directive and art. 44 UCITS directive.
[24] Art. 23 AIFM Directive and art. 75 UCITS directive.

sense of paragraph 1 for the alignment of the fund's strategy with the varying goals of the participants.

- From the point of view of transparency, it should also be possible to publish on the website the information that does not refer to client-by-client relationships, as referred to in paragraph 3, when this is in the interest of the relevant asset manager and his clients.

10. Transparency of proxy advisors (draft article 3i)

Eumedion is, in principle, in agreement with draft article 3i, since it contributes to an improvement in the quality of voting recommendations issued by proxy advisors. This does not alter the fact, however, that we believe consideration should be given to a number of points.

- It is confusing that the proxy advisory industry, on the instigation of ESMA, recently developed a set of Best Practice Principles that was published on 5 March 2014[25] and the European Commission is already overlaying these principles with proposed legislation. This is leading to a certain degree of uncertainty in the market at the moment. It does not seem advisable to use both policy instruments in tandem.
- What is lacking is a provision that encourages the proxy advisor to act in the interests of its clients.
- With regard to the discussion of draft voting advice with listed companies, as referred to in paragraph 2 subparagraph d, the dialogues should be confined to the prevention of material misstatements.
- When the dialogue with a listed company leads to a change in a voting recommendation, the proxy advisor should inform its clients accordingly. The draft article should be expanded in this respect.
- Eumedion wonders why it should be necessary to inform not only the clients of conflicts of interest, but the listed companies as well (paragraph 3). Listed companies are certainly not the clients of the proxy advisors, whose primary concern when taking action is the interests of their clients, who primarily experience the detrimental effect of a conflict of this kind.

11. Right to vote on the remuneration policy (draft article 9a)

The draft article comprises good regulations. In the Netherlands a legal provision has been in force since 2004 that a proposed remuneration policy must be submitted to the AGM for approval.[26] This right of approval for the AGM has strengthened the checks and balances relating to the approval of the remuneration of executives. After all, the supervisory directors have more of an executive than a supervisory task with regard to executive remuneration. The supervisory directors initiate and implement the remuneration policy (in contrast to other company policy

[25] http://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf.
[26] Section 2:135 par. 1 Civil Code of the Netherlands (hereafter BW).

areas), while the AGM monitors the way in which supervisory directors do this. This exceptional role relationship with regard to the executive remuneration requires the AGM to have a right to adopt the remuneration policy and a right to vote on the implementation of that remuneration policy. Eumedion welcomes the enshrinement of this role allocation in European legislation, so that it applies to all EU Member States. In this way, shareholders in all European listed companies have better guarantees that the process of establishing a remuneration policy is a careful one. Eumedion nevertheless still has a number of comments concerning draft article 9a.

- It is wise in Eumedion's opinion that it is stipulated that the remuneration policy should be submitted to the AGM for approval at least once every three years. This is more or less current practice in the Netherlands. Eumedion wonders, however, what the legal consequences are when supervisory directors award payments to executives on the basis of a remuneration policy that has not been submitted to the AGM for more than three years. Would this lead to invalidity of the remuneration decision?
- The second paragraph under 1. is curious in Eumedion's view. We believe that a remuneration policy should not be limited to (retaining and motivating) incumbent executives, but should also contain guiding principles for the recruitment of *new* executives. When the salaries of executives (and the 'golden hello' in particular) can systematically be arranged outside the terms of the remuneration policy, not only does the remuneration policy adopted by the AGM lose its relevance, but there is also a risk that excesses will occur that are concealed from the AGM.
- A proposal to grant stock options and/or performance shares to executives should also be submitted for approval to the AGM.[27] We appreciate the fact that paragraph 3 gives some substance to what the remuneration policy should invariably comprise. What is lacking, however, is that consideration should also be given to the pension reserves to be built up for executives.[28]
- Eumedion believes it would be going too far to stipulate that the remuneration policy submitted to the shareholder meeting for approval should – in principle – contain the ratio of the average remuneration of executives to the average remuneration of other full time employees of the company. We are not yet convinced that determination of the precise ratio should be one of the powers of the AGM. After all, the AGM approves the parameters for the executive remuneration, not of the company's employees. What is more, there are also all kinds of practical considerations, such as the definition of "average remuneration" and whether this remuneration must be calculated on the basis of the employees of the holding company or employees of all the corporation's operating companies, wherever these may be registered.

[27] See section 2:135 par. 5 BW.
[28] See section 2:135 par. 1 in conjunction with section 2:383c BW.

12. Remuneration report (draft article 9b)

The draft article on the remuneration report is a keystone of "*say on pay"* and contains useful provisions. Paragraph 3 of the draft articles provides shareholders with the necessary tool in cases the remuneration policy is inadequately implemented by the company. Now that the supervisory directors have in the Netherlands the legal power to adjust bonuses upwards or downwards on a discretionary basis[29], the importance of adequate accountability for the implementation of the remuneration policy has increased even more. Account should be rendered in this respect by submitting the remuneration report to the AGM to be voted on, as rightly provided for in the proposed directive.

A separate vote on the remuneration report also prevents shareholders from feeling it is necessary for them to vote against the proposal to discharge the supervisory directors for their supervision of the management of the company, if these shareholders object to the manner in which the remuneration policy has been implemented by the supervisory directors. This was recently an issue at the AGMs of Heineken and Corbion and at the KPN AGM in 2009. Furthermore, shareholders in other jurisdictions do not even have this "emergency brake" at their disposal. In the United Kingdom the initial experience of institutional investors with voting on the remuneration report have been positive. We do, however, have a few comments on the draft article.

- It is an omission that the draft article makes no reference whatsoever to the approved remuneration policy in the sense of article 9a, for which account is rendered in the remuneration policy.
- Paragraph 1 subparagraph f refers to "the remuneration committee'. In contrast to the audit committee for example, this remuneration committee has not yet been institutionally embedded in European legislation, but is merely included in a non-binding recommendation from the European Commission.[30] Eumedion asks that consideration should now be given to legal enshrinement.

13. Right to vote on related party transactions (draft article 9c)

Eumedion welcomes the draft article on transactions with related parties. When a listed company concludes a transaction with a related party and that transaction is not on market terms, the

[29] Section 2:135 paragraph 6 BW.
[30] See chapter 3 of the recommendation of the European Commission of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of management board members of listed companies (PbEU C 3177).

interests of shareholders can be prejudiced substantially. This risk exists specifically when the listed company has a shareholder with a controlling interest.

In order to be able to assess whether a transaction is being effected on reasonable terms that are in line with the market, shareholders need adequate information at the time of the transaction. Adequate information on the transaction and a right of approval for shareholders when the transaction is of significant magnitude (5% of the assets), as proposed in draft article 9c, ensure that minority shareholders have enough knowledge about the transaction and are protected against unfair or excessively expensive transactions.

A recent example of a related party transaction at a Dutch company where shareholders were given much too little information and were also not asked for their opinion, was the takeover of certain commercial activities at Salveo Biotechnology by Cryo-Save Group at the end of 2013. The CEO and the controlling shareholder of Salveo Biotechnology is Mr Amar who – via an intermediate holding company – is a major shareholder of Cryo-Save and a non-executive director of this company at the time of the transaction. Only a very brief press release was assigned to the transaction, which amounted to approximately 5% of Cryo-Save Group's total assets. It was and is completely unclear whether the transaction was settled on market terms. The external auditor certainly did not make a statement on this in the 2013 annual accounts of Cryo-Save Group.

On the grounds of IAS 24, every listed company is required to disclose all transactions with related parties.[31] Pursuant to IAS 24, there is no obligation to include a statement that all transactions with related parties have been effected on market terms. This is required, however, on the grounds of the Dutch Corporate Governance Code[32], although it is possible to deviate from this provision. When a transaction of material importance is concluded with a related party subject to non-market terms, article 17 subparagraph (r) Accounting Directive 2013/34/EU[33] requires that this be disclosed in the explanatory notes to the annual accounts. The transaction has already been settled by that time, however, and the shareholder whose interests have been damaged has no possible recourse.

[31] The disclosures relate to "the nature of the related party relationship, information about transactions, information about outstanding balances to understand the potential effects on the Annual Financial Statements, information about impairment or bad debts with related parties".
[32] Best practice provisions II.3.4, III.6.3 and III.6.4 of the Dutch Corporate Governance Code.
[33] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182).

Paragraph 1 of draft article 9c has an important added value, therefore, in the sense that there will soon be a guarantee throughout the European Union that significant transactions with related parties (> 1% of the assets) will be accompanied by a report from an independent third party, assessing whether the transaction is “fair and reasonable” from the perspective of the shareholders.

From the point of view of good governance and the protection of minority shareholders, it is highly desirable for transactions representing at least 5% of the total assets to be approved by the AGM, as provided for in paragraph 2 of draft article 9c. In addition, a qualitative criterion applies to the power to approve when a transaction represents less than 5% of the company’s assets, but may have “a significant impact on profits or turnover”. In this case too, the transaction must be submitted to the AGM. This is in principle a useful additional criterion, but it would be advisable if some further interpretation was given to the circumstances under which “a significant impact on profits or turnover” may be involved. We also believe it is quite obvious, therefore, that when a company concludes a related party transaction with a shareholder, this shareholder is excluded from the vote (paragraph 2, last sentence). After all, the shareholder in question has his own, possibly conflicting interest in the transaction. A similar provision has already been included in the decision-making process relating to the possible exemption of a party that has to launch a mandatory public bid[34] and in the decision-making process relating to the possible raising of the variable component of the remuneration of employees of banks and investment firms to 200% of the fixed component of the total remuneration (as a maximum).[35]

Paragraph 3 of draft article 9c is a worthwhile provision, because it helps to prevent a listed company from being able to cut up a related party transaction into a number of smaller transactions in order to circumvent the 1% and 5% asset thresholds respectively.

Paragraph 4 of draft article 9c, which contains an option for Member States to exclude application of the draft article to transactions with companies that are part of the listed company’s group and are wholly owned by the listed company in question, is useful and deserves the support of the Dutch government.

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[34] Section. 2, paragraph 1, section a, Takeover Bids Exemption Decree Wft.
[35] Art. 94, paragraph 1, subparagraph g, under ii, Capital Requirements Directive (‘CRD IV’).