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Subject:	Executive pay: review of measures undertaken by the Commission and Member States since the October European Council

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Delegations will find attached the revised EPC/EFC review of measures in the area of executive pay.

Encl.:



Brussels, 28 November 2008  
EPC/2008/REP/56146REV

### **Executive pay: review of measures undertaken by the Commission and Member States since the October European Council**

In the context of the unfolding financial crisis and fading public confidence, the European Council in October 2008 made a call for accountability on the part of all those involved in the financial system, particularly the banking sector. It emphasised that the performance of company executives should be reflected in their remuneration, including their severance pay ("golden parachutes"), which should be in line with their actual contribution to the success of the company. Likewise, care should be taken to ensure that earnings from stock options or the system of remuneration, especially in the financial sector, do not lead to excessive risk-taking or extreme concentration on short-term objectives. The Council called on Member States to work to put these principles into practice and invited the ECOFIN to report back on the decisions taken by the end of the year.

Following this mandate, and with a view to report back to the European Council, EFC members have been invited to update on the state of play on executive pay and recent measures taken, with a focus on 1) legislative measures already taken or envisaged; 2) codes of conduct (e.g. at the level of employers' federations); 3) specific measures taken in the context of the national rescue packages for the banking sector, e.g. in respect of bonuses, ceilings on executive pay of recapitalised banks. The annex lists the responses received.

The policy action undertaken in recent months can be summarized as follows:

- Following discussions earlier this year in the Eurogroup and ECOFIN of national frameworks regarding executive pay against the background of the Commission recommendation,<sup>1</sup> a large number of Member States have **strengthened legislative measures and/or codes of conducts**, or plan to do so in the near future.
- In the context of **national rescue packages for the financial sector**, many Member States have included in their schemes provisions regarding the remuneration of executives in the concerned institutions. They aim at **limiting the compensation and/or adjusting the incentive structure** to limit excessive risk-taking and to gear decision-making towards longer-term profitability.

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<sup>1</sup> based on a comprehensive review by the Economic Policy Committee of national frameworks

- Another focus of measures undertaken recently is on **improving transparency** of compensation components, in some countries disclosing up to the individual level, to give shareholders and responsible committees more information - and partly also introducing a shareholders' vote - on remuneration issues.
- Some countries have also taken action with respect to **severance pay**, either limiting the compensation as such or linking it to specific performance requirements.
- One country has revised the favourable **tax regime** in place for variable pay components, subjecting it to the personal income taxation.

This rapid review of the measures undertaken demonstrates that a number of Member States have in the recent months taken measures at national level going beyond the current recommendation by the Commission, which usefully promotes disclosure of remuneration policy, the remuneration of individual directors, and shareholder's approval, especially regarding share-based remuneration.

## Compilation of policy measures undertaken by Member States over the last months

### BELGIUM

#### 1. Legislative measures already taken or envisaged

Up to now Belgium did not have specific legislative rules concerning remuneration of executives and of leaving pay. However two separate “Corporate Governance codes”, one for listed companies (code Lippens 2004) and one for non listed companies (code Buysse 2005) were established. Up to mid-2008 they had not become formal legislation. Both codes provide “Good Governance” guidelines that were not compulsory as their philosophy was “comply or explain”. There was no sanction. Actually the Lippens code was in the process of revision, introducing more transparency.

The implications of the financial crisis for leading companies more especially in the financial sector and the elaboration of rescue plans urged the government to regulate by law a certain number of principles that already were part of the revised Lippens code. Two separate proposals of law, regarding listed companies only, were approved by the government on November 07 2008 and are expected to be voted in parliament by the end of 2008. The first law regulates the creation of a remuneration committee and determines the different aspects of the remuneration policy that have to be clearly decided and communicated on a transparent way for the various members of the board and of executive management. The second law deals with the problem of the golden parachutes, limiting leaving pay to 12 months of remuneration with a maximum of 18 months (18 years in the company).

#### 2. Codes of conduct

Both codes of conduct for listed and non listed companies are in a process of revision and will have to take into account legislative regulation that already has been approved.

### BULGARIA

In compliance with the ECOFIN Council Conclusions of 7 October 2008 as well as the European Council Conclusions of 15-16 October 2008, there is a draft Law amending the Law on Credit institutions, which includes text concerning the executive pay. The draft Law was submitted to the European Central Bank (ECB) for legal opinion and the text was supported by the ECB. The Law amending the Law on credit institutions is pending approval by the Council of Ministers in November and further on by the National Assembly.

The following text is proposed to be added to the Chapter Eleven, Section VI “Supervisory measures”, Art 103 (2), 12 “...the Bulgarian National Bank may”:

“...forbid a payment of bonuses, premiums, tantiems and other forms of additional remuneration of the administrators of the bank, which are not included in their main remuneration, agreed in the management contracts.”

## DENMARK

1)

Denmark has in June 2007 implemented legislation which entails that shareholders of listed companies have to approve in general meeting the general guidelines for the company's overall incentive pay to the board and executive management prior to any specific agreements being made.

2)

The following is a section VI from Committee on Corporate Governance's Recommendations for corporate governance ([www.corporategovernance.dk](http://www.corporategovernance.dk)).

### **VI. Remuneration of the members of the supervisory board and the executive board**

*Competitive remuneration is a prerequisite for attracting and retaining competent members of the supervisory board and the executive board. The remuneration of the members of the supervisory and executive boards should be reasonable in relation to the tasks assigned and the responsibilities involved in performing these tasks.*

*Performance-related pay may result in convergence of interests between the shareholders and the management of the company and may cause the management to focus on increasing the company's value creation.*

*It is essential that there be openness about all important issues regarding the principles and amounts of the total remuneration offered to the members of the supervisory board and the executive board.*

#### **1. Remuneration**

*The Committee **recommends** that the total remuneration (fixed pay, incentive pay covering all forms of variable pay, pension, severance pay and other benefits) be at a competitive and fair level, reflecting the independent performance and value creation in the company of the members of the executive board and the supervisory board.*

#### **2. Remuneration policy**

*The Committee **recommends** that the supervisory board adopt a remuneration policy and that the company disclose the contents of such policy in its annual report and on the company's website. The Committee **recommends** that the remuneration policy reflect the interests of the company and the shareholders, match the specific conditions of the company and be reasonable in relation to the tasks and responsibilities undertaken and that it promotes long-term behaviour and is transparent and easy to understand.*

*The Committee **recommends** that the remuneration policy include a statement explaining the fixed pay and the overall principles of the incentive pay programme (covering all forms of variable pay), including the terms of the vesting/granting of bonus/performance-related bonus and/or price-related incentive schemes, etc., as well as pension schemes and severance programmes and other benefits. Information about the relationship between the fixed pay, the incentive pay and the other elements of the pay is a part of the remuneration policy.*

*The Committee **recommends** that any defined benefit schemes be disclosed.*

*The Committee **recommends** that the company's remuneration, including incentive pay, policy reporting include a statement explaining how such policy was implemented in the past financial year, how such policy is implemented in the current financial year and how the company plans to implement it in the next financial year.*

*The Committee **recommends** that the remuneration policy contain clear and comprehensible information that is easy to understand by the individual shareholder and which enables the shareholder to see that the supervisory board complies with the remuneration policy and the guidelines adopted for incentive pay. Thus, there must be a connection between the information communicated to and approved by the general meeting prior to the granting and the annual report stating the facts after the granting.*

*The Committee **recommends** that the company's remuneration policy be mentioned in the statement given by the chairman at the company's general meeting and that the remuneration of the supervisory board for the current financial year be presented for adoption at the general meeting when the annual report for the previous year is submitted for adoption.*

### **3. General guidelines for incentive pay**

*The Committee recommends that the general guidelines for incentive pay reflect the interests of the shareholders and the company, match the specific conditions of the company and be reasonable in relation to the tasks and responsibilities undertaken. There must be a connection between the information communicated to and approved by the general meeting prior to the granting and the annual report showing the specific results of the approved guidelines for incentive pay.*

*The Committee recommends that the remuneration of the members of the supervisory board not consist of share option schemes, but e.g. bonus schemes and shares at market price.*

*If the remuneration of the members of the executive board consists of share or subscription options, the Committee recommends that the schemes be set up as roll-over schemes (i.e. the options are granted periodically e.g. every year and expire over a number of years) and that the redemption price be higher than the market price at the time of granting.*

*The Committee recommends that incentive pay programmes be designed in such a way that they promote long-term behaviour and are transparent and easy to understand, even for outsiders, and that valuation at the time of granting be made according to generally accepted methods.*

*[Comment: Section 69b of the Danish Companies Act provides that the supervisory board of the company must have specified general guidelines for incentive programmes for the company's supervisory board or executive board before the company can enter into a specific agreement on incentive pay with a member of the supervisory board or the executive board. The guidelines must be considered and approved by the company in general meeting.]*

### **4. Severance programmes**

*The Committee recommends that information about the most important aspects of severance programmes be disclosed in the company's annual report.*

*[Comment: Severance programmes cover a wide area, including number of years' notice and qualification, change of control agreements, 'golden handshakes', insurance and pension schemes, payment of pension contributions after retirement, etc. Pursuant to section 107a of the Danish Financial Statements Act a company's annual report shall include information on special retirement agreements resulting from a successfully completed takeover bid. If, in exceptional cases, severance programmes include an element of incentive pay, such programmes shall be covered by section 3.]*

### **5. Openness about remuneration**

*The Committee recommends that the annual report include information about the amounts of total remuneration of the individual members of the supervisory board and the executive board provided by the company or other companies within the same group.*

*[Comment: The annual report should contain all, clear and comprehensible information about the remuneration of the individual members of the management body that is easy to understand by the individual shareholder and which enables the shareholder to follow up on the compliance with the remuneration policy and the general guidelines adopted for incentive pay.]*

## **3)**

Sections from the unofficial translation of the Danish Act on Financial Stability ("National Rescue Package") by the Ministry of Economic and Business Affairs.

*13. Banks participating in the arrangement are not allowed to initiate new share purchase programmes whilst the arrangement is in force, and existing share purchase programmes must not be prolonged or renewed.*

*17. (3. bullit) Financial sector institutions are subject to a special regulatory regime because they play a special role on the economy at large and because they manage the funds of depositors. Therefore, incentive structures embodied in management compensation is particularly important in the financial sector. There is a need to tighten rules regarding the use of stock option programmes in order to limit variable pay components.*

## GERMANY

### 1. General measures envisaged

The coalition of the SPD and CDU/CSU has established a parliamentary working group to analyse the problems of excessive management compensation. The working group has identified several areas of possible legislative action; no official decisions have been made yet, but they will be taken soon. So far the following can be said:

- There will no general cap for management compensation in the law.
- In the German two tier-system, it is the Supervisory Board (*Aufsichtsrat*) which is responsible for deciding upon the compensation of the Managing Board (*Vorstand*). In the law it should be ensured that the *Aufsichtsrat* fulfils its duties in a proper way. The law could furnish the *Aufsichtsrat* with comprehensive guidelines for determining the appropriate compensation.
- The law should in particular insist that the *Aufsichtsrat* must introduce compensation incentives which provide a long-term orientation for the managements' behaviour, instead of short-term incentives. This is one of the most important lessons to be learned from the financial crisis.
- It should not be a subcommittee of the *Aufsichtsrat*, but the *Aufsichtsrat* as a whole that has the final decision about a *Vorstand*-contract.
- It might be considered whether the law can furnish effective instruments to lower compensations when the situation of the company deteriorates. It should also be considered whether gratifications etc. should be dealt with in such a way that they can be recalled in cases of subsequent negative developments.
- Stock options might be exercised only after a holding period of three or four years.
- The transparency of the compensation, especially of retirement plans, change of control clauses etc. could be increased.

The working group will have an Expert Hearing and then arrive at a decision shortly.

### 2. Measures taken in the context of the national rescue packages for the banking sector

A recent legislative measure can be found in the Financial Market Stabilisation Act, which entered into force on 18th October 2008. This Act aims at guaranteeing the financial system's stability and ability to function. The Act establishes a Federal Government special fund which is used to provide for three different stabilisation measures: guarantees, recapitalisation and acquisition of assets. These stabilisation measures are not for free but can be linked to certain behavioural conditions. These conditions include:

- Review of compensation systems as to the incentives they provide and their appropriateness. Compensation systems should not tempt management to take inappropriate risks but should be oriented on long-term, sustainable goals and should be transparent.
- Limiting compensation of board members and managers to a reasonable amount. In particular, total compensation should not exceed € 500,000 a year. In addition, no bonuses should be paid and no severance pay should be paid which is not required by law.

## ESTONIA

### **1) legislative measures already taken or envisaged**

Currently the governance issues in general, including the pay matters and possible conflict of interests situations, are regulated by the Business Code and as much as necessary in the specific sector legislation, eg the Credit Institutions Act, Securities Market Act, Insurance Activities Act, Accounting Act, Authorised Public Accountants Act.

### **2) codes of conduct (e.g. at the level of employers' federations)**

Tallinn Stock Exchange and Financial Supervisory Authority have issued a good practice guidelines for the listed companies, which also includes the recommendations concerning the executive pay.

### **3) specific measures taken in the context of the national rescue packages for the banking sector, e.g. in respect of bonuses, ceilings on executive pay of recapitalised banks**

The legislative initiative facilitating the provision of guarantees or other support instruments at the time of crises under discussion at the moment will include provisions concerning the executives pay.

## GREECE

The Greek Government has proposed a draft law (already approved by EU Commission and passed by the Parliament) *“For the enhancement of liquidity of the economy in response to the impact of the international financial crisis”*. In order to assist the recapitalisation of Greek banks, up to 5 billion euro can be used by the State to buy preferred shares of banking institutions, while guarantees up to 15 billion euro are provided for new borrowing by banks. According to this legislation, when banking institutions take advantage of these facilities, the Greek State has the right to be represented in the General Assembly and the Board of Directors, by a representative who may be appointed as an additional member to the Board of Directors. This representative has the power to veto any decision related to dividends distribution and to the policy regarding benefits to the President, the Managing Director and other members of the Board of Directors, General Directors and Deputy General Directors, if he / she considers that such a decision could endanger the interests of depositors or substantially affect the solvency of the bank. In any case, the above-mentioned benefits cannot exceed the total amount of benefits received by the Governor of the Bank of Greece. All additional bonuses of the same persons are abolished for the period of application of this specific law. The same representative is present at the General Assembly of ordinary shareholders and has the right to veto during the discussion and decision-making process regarding the issues mentioned above.

In addition, Law 3697/2008 provides for the taxation of stock options according to rules pertaining to regular personal income.

## FRANCE

Private sector recommendations relative to executive pay have been reinforced in October 2008. These recommendations apply in priority to listed companies and should be followed by compensation committees, on the basis of comply or explain principles. The main elements are the following:

### **1/ Improve the transparency of all compensation items**

The components of compensation applicable to each executive director must be made public on an individual basis, in accordance with applicable provisions of law and the further recommendations issued by AFEP and MEDEF. However, the clarity of the said information can still be improved.

To that end, it is recommended to:

- comply with the standardized format defined by AFEP and MEDEF (see attached tables) as regards all director compensation components (including the valuation of the awarded stock options based on the method selected for the consolidated financial statements);
- disclose all components of the executive director compensation, whether potential or vested, immediately after the meeting of the board approving the same.

### **2/ Termination of the employment contract in the event of appointment to a corporate office**

This recommendation applies to the chairman, to the chief executive officer of companies having a board of directors, to the chairman of the management board, to the sole managing director of companies having a management board and a supervisory board, and to statutory managers of limited stock partnerships.

The high level of compensation of executive directors of listed companies is justified in particular by the assumption of risks. Accordingly, such compensation cannot be granted concurrently with the benefits of an employment contract.

Accordingly, when a senior executive becomes an executive director of the company, it is recommended to terminate his or her employment contract with the company, either contractually or by resigning.

### **3/ Golden parachute**

The law gives a central role to shareholders, imposes total transparency and makes termination payments conditional on performance requirements. The performance requirements imposed by the boards must be demanding and may authorize the indemnification of an executive director only in the event of an imposed departure linked to a change of control or change in strategy.

Private sector recommendations recommend that termination payments may not be granted to executive directors who decide to leave the company in order to hold another position or change their position within the group or are entitled to exercise their rights to pension in the near future.

Where applicable, the termination payments may not exceed two years of compensation (fixed and variable).

These rules and the above-mentioned cap apply to all indemnities and include in particular any indemnities paid pursuant to a non-compete clause. Any artificial increase in the compensation during the period preceding the departure is to be prohibited.

Limit the golden parachute to two years pay, and exclude the payment of such parachute in case of voluntary departure, when changing responsibilities in a same group or when the beneficiary is going to retire.

#### **4/ Strengthening the supervision of the additional pension rights**

The companies' right to offer additional pension schemes to their executive directors must comply with conditions, so as to avoid any abuse, excluding for example any schemes that give a right, whether immediately or over few years, to a high percentage of the total compensation at the end of the career.

#### **5/ Determination of additional rules relating to stock options and the award of performance shares, in particular to better involve the employees in the company, ensuring that**

the award of performance shares to executive directors must be conditional on performance requirements. Detailed rules concerning the award, the prices and the exercise of the options have been defined.

The French government has asked companies to comply with these recommendations by the end of 2008, and their implementation will be monitored. If there were not implemented, the Government may decide to pass a law. The Parliament has already agreed to the government proposal to exclude by law the possibility to grant stock option to executive when the company does not have any mechanism to ensure employees' participation to the benefits of the company.

The Parliament also decided to limit the amount of "golden parachutes" which can be deducted from taxable benefits to 200 000 euros. This measure is incorporated to the budget project currently under examination.

As part of the rescue plan for banking sector, the guarantee granted by the State to financial institutions is submitted to the conclusion of an agreement through which those institutions and their management commit themselves to ethical rules of common interest. Among these engagements, they are committed to respect a set of principles on executive pay (notably : (i) limiting the amount of "golden parachutes" ; (ii) the prohibition of "golden parachutes" when the institution or the management failed ; (iii) the obligation that gratuitous stock be linked with performance ; (iv) the existence of a dedicated committee in the executive or surveillance board).

## IRELAND

Under the framework of the ten-year social partnership agreement *Towards 2016* the Government concluded a Transitional Agreement on pay and workplace issues with the social partners which responds to the immediate challenges facing the economy. In the context of the changed economic circumstances, and the acceptance by the social partners of the importance, in the national interest, of observation of pay moderation under this new agreement, employer bodies agreed that they will, as a matter of policy, encourage their members to ensure that pay moderation is also observed in respect of executive pay.

Under the provisions of the Credit Institutions (Financial Support) Act 2008 (2008 Act) the Minister introduced a guarantee scheme (The Credit Institutions (Financial Support) Scheme 2008) to cover specified credit institutions and specified liabilities. The Scheme came into effect on 30th September 2008 and will cease on 29th September 2010.

The Scheme which sets out terms and conditions for the covered institutions provides for the Minister for Finance to establish an independent committee called the Covered Institution Remuneration Oversight Committee (CIROC) to oversee all remuneration plans of directors and senior executives of the covered institutions. Under the terms of the Scheme each covered institution has to submit a plan to structure the remuneration packages of directors and executives so as to take account of the objectives of the 2008 Act. Such plans cover total salary, bonuses, pension payments and any other benefits including share options received by senior executives from the covered institutions in respect of performance.

Each covered institution must submit its report to CIROC, within 6 weeks of joining the Scheme, demonstrating how its remuneration policies for the year ahead comply with the terms of the Scheme. CIROC shall prepare a report to the Minister within 3 months of receipt of the covered institutions reports, advising the Minister in cases where a covered institution is not complying with the requirements of the Scheme. The Minister may direct the institution to amend the remuneration plan so that compliance is achieved.

In addition under the terms of the Scheme a covered institution cannot enter into contractual arrangements that provides for termination compensation to be payable to any director or executive for the duration of the scheme.

## ITALY

On 6 August 2008, Italy's Parliament approved Law n° 133/2008 introducing significant amendments to the taxation of companies, individuals, non-residents and real estate funds.

In particular, with reference to the taxation of individuals (for executives as for any other worker) the favourable tax regime for stock option plans reserved and offered to them has been repealed. According to the previous regime, the difference between the fair market value of the shares<sup>2</sup> delivered upon the exercise of options and their strike price (the so called capital gain) was exempt from progressive personal taxation and taxed at the flat rate of 12.50 per cent.

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<sup>2</sup> Under guidelines issued by the Ministry of Finance, the Fair Market Value of a share traded on a stock exchange is equal to the average of the closing prices during the period ending on the grant date and starting on the same day of the preceding calendar month.

Under the new law, the main change is that, starting from June 25, 2008 the income deriving from stock option plans will be subject to ordinary (progressive) taxation for personal income tax.

Regarding the role of shareholders in determining executives' compensation, a recent decision by the Corte di Cassazione established that the shareholders' meeting should endorse the compensation of members of the board of directors with a specific deliberation rather than within the context of companies' budget approval.

Specific rules on remuneration and compensation schemes for banks' board members have been issued on 4 March 2008 by the Bank of Italy as part of a more comprehensive regulation on banks' organization and corporate governance.

The new rules address both concerns mentioned in the European Council conclusions, namely that shareholders should have adequate control over remuneration, and that remuneration schemes should provide the right incentives. The rules specify the following:

- a) The shareholders' meeting must be involved in setting ex ante remuneration policies and equity-based compensation plans.
- b) Shareholders must be provided with ex post information on the practical implementation of remuneration policies.
- c) Large banks must set up a remuneration committee within the board, composed by a majority of independent directors, to provide advice and make proposals on directors' remuneration and perform advisory tasks in relation to determining the criteria for managers' remuneration.
- d) Remuneration policies and compensation schemes must be consistent with prudent risk management and the company's long-term objectives and must ensure an appropriate balance between their fixed and variable components. The variable component must further ensure an equilibrium between short-term and long-term performance and its consistency with the bank's actual and lasting results; and performance-related compensation must be risk-weighted.
- e) Equity-based compensation or bonuses linked to performance are limited or prohibited for members of control bodies, non-executive directors (especially members of board committees such as the audit committee) and managers in charge of internal control.

## CYPRUS

1. No legislative measures have been taken up to now in this area.
2. In Cyprus, rules for remuneration of executives are subject to the Corporate Governance Code of the Cyprus Stock Exchange (CSE). Section B of the Code refers exclusively on Directors' Remuneration. The Code is obligatory only for the companies' listed in the main market of the CSE (i.e. listed companies with a capital value exceeding 9mn euro, 25% of the share capital to the public, major shareholder up to maximally 70%). The main market in Cyprus has 15 listed companies. It is noted that three out of the 15 listed companies in the main market are banks. All other listed companies may apply any section of the Code on a voluntary basis. If they wish to apply some sections of the Code they should state so in their annual accounts.

Directors' remuneration for all the public companies is disclosed in the Company's Annual Report, according to the International Accounting Standards.

According to the Code, the Board of Directors should submit an annual Remunerations Report to shareholders. This report should constitute a part or annex of the company's annual report. It should contain a statement of the remuneration policy and related criteria as well as details of the remuneration of the executive and non-executive directors. It should be the main tool with which the company may report to the shareholders on directors' remuneration. The total amount of remuneration should be broken down into remuneration for services rendered as members of the Board of Directors and remuneration for executive services. The total amount of remuneration of Executive Directors should be analysed per categories of €85,000 (total remuneration and number of directors by category, e.g. three Executive Directors with remuneration between €85,000 – €170,000).

There is no reporting obligation for breakdown of remuneration into salary and other components such as bonus payments. Schemes such as stock options for top executives should be approved by an Extraordinary General Meeting of Shareholders.

The report should set out the company's policy on remuneration of executive directors. The report on the company's remuneration policy should also be placed on the company's official website. It should emphasize specific factors that concern the company, such as linking of executive remuneration to company performance.

The Remuneration Committee of a company should examine the compensation commitments (including pension contributions) in executive directors' contracts, if any, in the event of early termination. Where the initial contract does not explicitly provide for compensation commitments, the remuneration Committee should, within legal constraints, adapt its approach to cases of early termination according to the specifics of the case. The wider objective should be to avoid rewarding poor performance, while at the same time dealing fairly with cases where termination is not due to poor performance and following a strict policy of reducing compensation to reflect the departing director's obligation to mitigate loss.

The Corporate Governance Advisory Committee<sup>3</sup> is currently examining the modification of the Code so as to introduce the following amendments for the executives' remuneration:

- An implicit disclosure of the remuneration of directors by name should be required for the companies for which the code is obligatory.
- The Remuneration Policy Report should include guidelines on bonus and compensation as well as performance criteria based on a medium term horizon instead on an annual basis.

3. No national rescue packages have been adopted.

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<sup>3</sup> The Corporate Governance Advisory Committee was set up with the primary objective to discuss amendments, which may be deemed necessary to the Code. It comprises representatives from the Cyprus Stock Exchange, the Cyprus Securities and Exchange Commission, the Public Companies Association, the Investment Firms Association, the Cyprus Institute of Directors, the Registrar of Companies and the Cyprus Association of Accountants.

## LATVIA

### **1) Current legal acts do not set any regulations on executive pay for the private banks. There are no legislative measures envisaged.**

However government regulates executive pay for Members of the Board and the Council and representatives of the state in the Board or Council) in the State and local government enterprise (Cabinet of Ministers Regulation No. 704, dated on 16.12.2003). This regulation is applicable for state owned bank as well.

There are planned amendments, that will prescribe that person may take position as representative of the state not more than in two very large enterprises or not more than in three large enterprises or not more than in four medium enterprises or not more than in five small enterprises.

Total maximal remuneration as state representative in all enterprises may not exceed 1500 lats (per month).

### **2) There is no code of conduct in place at the level of employers' federations.**

### **3) There is no “national rescue package for the banking sector” in Latvia.**

The Government intervention in JSC „Parex Banka” (by purchasing control ownership of 51 % on 10th of November 2008) as systemically important bank was urgent and necessary to remedy a serious disturbance in the financial system and economy in whole. This cannot be classified as rescue aid but an aid for insurance of stability of state economy.

In parallel, amendments in national legal acts were prepared, which adopted by the Parliament on 14 November 2008, necessary to create general state aid scheme to support financial institutions in the context of the current global financial crisis. Till the end of November 2008 generally applicable state aid scheme might be created in Latvia.

As regards to the remuneration, the Council of "Parex Banka" will set the pay for the members of the Board taking into account the financial situation of the bank.

## HUNGARY

The Hungarian Government adopted and submitted to the Parliament a proposal on strengthening the financial intermediation system. According to the draft legislative proposal, banks can draw on recapitalisation accepting certain conditions. Where recapitalisation occurs, the Government can delegate at least one member to both the Executive and Supervisory board, where decisions on executives' pay can be influenced.

## NETHERLANDS

### *Legislative measures and/or codes of conduct*

In September, a bill on three tax measures dealing with payments to employees in the highest income group has been approved by the House of Representatives. Currently the bill is under discussion in the Senate.

The proposed measures are:

- First of all, the use of tax facilities with respect to disproportional pension payments over the past, are discouraged. For that purpose a new employers' tax is introduced on back service payments regarding wages in excess of € 500,000. These back service payments are taxable at a rate of 15%.
- Secondly, a new employers' tax at a rate of 30% is introduced on disproportional exit bonus payments. These payments are considered to be disproportional if and insofar the payments exceed the employee's annual wage. This extra tax is only applicable if the annual wage of the employee exceeds € 500 000.
- Finally, the tax regime of carried interest payments of private equity managers will be replaced by a new tax regime. Carried interest is a share in the profits of a partnership or a holding company, that is paid to the manager of a private equity fund or the manager of the target company that has been taken over. Under current Dutch tax law the actual taxation of carried interest payments can be under discussion, depending on the situation at hand. Therefore carried interest payments will be subject to a new regime that provides for an unambiguous and well-balanced taxation.

The first measure (disproportional pension payments) is expected to come into operation on 1-1-2010. The other measures are expected to come into operation on 1-1-2009. These measures are carefully targeted on excessive employment payments. Not only by the choice of certain specific kinds of payment that are affected by the measures, but also by using income limits.

The measures will expectedly result in either less excessive employment payments (adjusting behaviour in the desired direction) or higher tax revenues.

### *Codes of conduct*

Dutch company law contains e.g. provisions on settlement of remuneration as well as disclosure requirements. Supplemented by the Dutch corporate governance Code (referred to below as the Code) which contains principles and best practice provisions for good corporate governance. Compliance with the Code is mandatory by law for Dutch listed companies. Compliance is in accordance with the 'apply or explain' principle. In other words, provisions of the Code should be applied unconditionally or an explanation should be given for any departure from them. The management board and supervisory board of a company account to the shareholders for the corporate governance structure that has been adopted and for compliance with the Code. The Code contains e.g. provisions on composition of executive pay (level of severance pay, period of holding on shares or stockoptions etc.), remuneration commission, and remuneration report.

On 4 June 2008, the Committee launched a public consultation of proposed amendments to the Dutch corporate governance code in relation to management board remuneration, diversity in the composition of the supervisory board, shareholder responsibility and the role of the management and supervisory boards in takeovers. The Committee's proposals include the following in relation to executive pay:

- stronger control by the supervisory board over management board remuneration (by means of scenario analyses, claw-back clauses, ultimate remedy and maximum ratio between fixed and variable remuneration);
- greater transparency concerning relationship between remuneration and performance;
- better accountability and more clarity in respect of the variable remuneration of management board members;
- greater transparency concerning severance pay and change-of-control clauses;

In December 2008, the Monitoring Committee intends to adopt the amended Code.

### ***Special measures taken in the context of the national rescue packages for the banking sector***

For recapitalization-packages of ING, AEGON and SNS, the banks and the government agreed on the following:

- Issuer's Supervisory Board will develop a sustainable remuneration policy for the Executive Board and Senior Management that is aligned to new international standards. These incentive schemes will be linked to longterm value creation, taking account of risk and restricting the potential for "rewards for failure".
- Issuer's Executive Board to forego all bonuses for 2008 (cash as well as options and share rewards).
- Issuer's Executive Board to limit exit schemes or statutory compensation for dismissal to one year's fixed salary.

For the Government Guarantee-arrangement the following conditions are set for remuneration and severance arrangements of banks:

- It shall or, if it is a subsidiary, it shall ensure that its parent company will, implement and maintain a sustainable remuneration policy for its (or its parent company's, as the case may be) managing and executive directors and senior management in line with international standards and that its (or its parent company's) incentive schemes will be linked to long term value creation taking account of risk and restricting the potential for "rewards for failure".
- It shall or, if it is a subsidiary, it shall ensure that its parent company will, ensure that the exit schemes or statutory compensation for its (or its parent company's, as the case may be) executive board shall be limited to one year's fixed salary and that remuneration shall be consistent with its (or its parent company's) long term objectives.

- It shall or, if it is a subsidiary, it shall ensure that its parent company will, comply with all other remuneration related provisions set out in paragraph II.2 of the Dutch Corporate Governance Code.

## **AUSTRIA**

### **1. Specific measures taken in the context of the national rescue packages for the banking sector**

Financial institutes drawing on the Austrian rescue package are obliged to reassess the incentive structure of their remuneration system and its adequacy as well. The remuneration system should not induce excessive risk taking and be geared to sustainable developments.

The executive pay has to be based on the following principles:

- Adequacy of the remuneration, premiums or similar payments.
- Limitation of the executives' payment to an adequate extent taking into account, i.a. the contribution of the executive to the company's success and its risk management so far.
- Existing agreements on business objectives, option programmes or performance related payments must not be changed ex post for the benefit of the executives.
- Share holder programmes for executives are to be suspended as long as the public sector is holding shares.

Furthermore, the financial institute is – under certain conditions - obliged to recall already carried out payments for executives, if they have contributed considerably and harmfully to the financial situation and the amount is considered as being inadequate.

### **2. Legislative measures already taken or envisaged**

The revision of the Austrian Code of Corporate Governance which will be finalised shortly aims at strengthening the rules for transparency of the remuneration of the executive directors (i.e.: publication of the executives' payments on a single basis ⇨ to become a “comply or explain-measure”). Furthermore the remuneration should be geared to a higher content on sustainable developments.

Further details can be provided as soon as agreement is reached.

## **POLAND**

The legislation on financial markets does not define directly the level of the executive pay and publication duties on this specific issue. The law on executives' remuneration in some legal persons from 3rd March 2000 with further amendments (Ustawa z dnia 3 marca 2000 r. o wynagrodzeniach osób kierujących niektórymi podmiotami prawnymi, Dz. U. Nr 26, poz. 306 z późn. zm.) is the only binding law, which includes regulations on maximum pay of the members of Board. Its provisions are adapted to the specific list of public sector bodies. Executives remuneration in public companies with majority State Treasury shareholding shall not exceed a total of 6 average remunerations in enterprise sector without premium profits in IV quarter of the previous year.

Moreover capital market participants, mainly clearing houses, persons conducting activity on regulated market, investment companies and public companies are run in the form defined in the Commercial Code from 15 September 2000 with further amendments (Ustawa z dnia 15 września 2000 r. kodeks spółek handlowych, Dz. U. Nr 94, poz. 1037 z późn. zm.). This law does not provide directly the limits to define executive pay, but gives suitable bodies like supervisory board or the general meeting of shareholders measures to form management pay. According to 368 § 4 of the mentioned law, members of the management board are called and dismissed by supervisory board, unless the charter of company deliver in a different manner. The supervisory board has also the right to define management pay, unless the charter of company delivers it in another way.

The Supervisory Board of the Warsaw Stock Exchange adopted by Resolution no. 12/1170/2007 on 4th July 2007 “Good Conduct in Quoted Companies”. The code has been in forced since 1st January 2008. The main aim of its adoption were strengthening of the transparency of quoted companies, communication improvement between companies and investors and strengthening of the stockholders protection. This code of conduct defines also that remunerations of the members of the companies' bodies should be connected with the scope of their tasks and responsibilities, and reflect the size of the company and its economic performance.

## PORTUGAL

### 1. Legislative measures already taken or envisaged

#### **Proposal for a new law on the remuneration policy of public interest entities**

(Proposal N° 227/X, under discussion in the Parliament -

<http://app.parlamento.pt/webutils/docs/doc.doc?path=6148523063446f764c3246795a5868774d546f334e7a67774c325276593342734c576c75615668305a586776634842734d6a49334c5667755a47396a&fich=ppl227-X.doc&Inline=true>):

- Firstly, it foresees the introduction of a rule according to which a declaration on the remuneration policy of the board of directors and of the supervisory board of public interest entities must be submitted and approved by shareholders in a general meeting. Public interest entities (as defined in Directive 2006/43/EC) includes, among others, credit institutions and issuers of securities listed on regulated markets.

The declaration on the remuneration policy shall include information on the following items: *(i)* criteria for the variable parts of remuneration systems; *(ii)* stock options plans; *(iii)* criteria for the evaluation of executives' performance focused on the long term; *(iv)* remuneration ceilings in case of company's performance deterioration.

- Secondly, includes a rule requiring public interest entities to disclose annually (on the annual reports or, in the case of listed companies, on the corporate governance statement) *(i)* the remuneration policy of the board of directors and of the supervisory board and *(ii)* the remuneration amounts received by the members of the board of directors and of the supervisory board, either on a individual or aggregated form.

### 2. Codes of conduct

No updates.

### 3. Specific measures taken in the context of the national rescue packages for the banking sector

#### **Law n° 62-A/2008, of 11 November**

(<http://www.dre.pt/pdf1sdip/2008/11/21901/0000200004.PDF>):

Following to the nationalization of shareholdings, members of corporate bodies of intervened entities are not entitled to compensation in case of dismissal, notwithstanding any contractual arrangements in place.

## **SLOVENIA**

### **1. Legislative measures related to executive pay taken before the crisis**

In March 2007, Banka Slovenije adopted the Regulation on the diligence of members of the management and supervisory boards of banks and savings banks. This Regulation, among others, in the Article 8 stipulates as follows:

*(1) Payments, reimbursements and other benefits for members of management and supervisory boards shall be defined in such a way as not to encourage concession of damaging risk assumptions, for example, to maximise short-term operating results.*

*(2) Payments, reimbursements and other benefits of member of the management board shall be defined by the supervisory board on the basis of previously determined criteria, which shall include at a minimum the following:*

- (a) the scope of duties of an individual member of the management board,*
- (b) the successfulness of an individual member of the management board,*
- (c) the size of the bank and its financial position,*
- (d) the complexity of managing the bank with regard to its level of business and organisational development,*
- (e) the general economic conditions in which the bank operates,*
- (f) the successfulness of the bank's operations,*
- (g) implementation of strategic and annual plans.*

*(3) A member of the management or supervisory board shall be obliged to refuse payments, reimbursements or other benefits in the cases set out in the first paragraph of this article.*

*(4) A member of the supervisory board is also obliged to refuse payment of personal liability insurance from the bank accept that portion of damages that exceeds his/her assets and that it is not possible to return to the bank without insurance.*

### **2. Codes of conduct**

The Managers' Association of Slovenia has some time ago issued recommendations for managers' contracts containing a rather detailed and comprehensive set of recommended criteria and other elements for determining managers' salaries and other remunerations.

### **3. Specific measures taken in the context of the national rescue packages for the banking sector**

The Slovenian Parliament adopted on November 11, 2008 amendments of national laws containing several measures available to support the financial institution(s), with registered seat in Slovenia, faced with international financial crisis. In general the purpose of the measures now available is to prevent harmful spill-over effects on the financial system and the economy. These measures are:

- State guarantees for refinancing operations by credit institutions with registered seat in Slovenia in Slovenia (up to 12 billion EUR). The guarantee can be given by the Ministry of Finance or by an institution, authorised by the Government to do so.
- Loans to credit institutions, insurance, reinsurance and pension companies with registered seat in Slovenia. Conditions and other prerequisites will be determined with by-laws and/or government orders.
- Assets repurchase for credit institutions, insurance, reinsurance and pension companies with registered seat in Slovenia. Conditions and other prerequisites will be determined with by-laws and/or government orders.
- Capital investments by the Republic of Slovenia in credit institutions with registered seat in Slovenia. Conditions and other prerequisites will be determined with by-laws and/or government orders.

Within the adopted amendments it is further stipulated that the Government, in case of approving any of the above mentioned measures, can limit managers' salaries and other remunerations, including stock options of the company. The imposed limitations can be in place only as long as the measure taken (up till the moment when capital investment is sold or credit repayed). There is no detailed formal provision on the subject and, as there has been no case of imposing of any of the measures mentioned above, there is no experiences on implementation available either.

## **SWEDEN**

### **1. Legislative measures**

#### *The Companies Act and the Insurance Business Act*

In March 2006 the Swedish government presented a bill on the subject of remuneration of directors. The Parliament has adopted the bill and new legislation came into force by 1 July 2006. It is concluded in the government bill that the new rules are well in line with the EU Recommendation on the subject.

According to the new rules, the annual general meeting of Swedish listed companies shall decide on the remuneration policy. The policy is binding on the board of directors and the managing director. Upon special cause, the board may, however, deviate from the policy providing that the policy allow it. – Regarding members of the board of directors, it should be noted that the annual general meeting shall decide on the remuneration of each one of the members. Hence, this decision is not only a matter of policy.

The board of directors proposes to the general meeting a certain remuneration policy relevant for the period until the next general meeting. The policy shall be incorporated in the statutory administration report (a part of the annual report according to Swedish law). The company's statutory auditor has been given the task of – in addition to the regular audit – examine if the policy are followed or not. It is then normally the duty of the board of directors to, in accordance with the policy, decide on the remuneration of the managing director and the duty of the managing director to, also in accordance with the policy, decide on the remuneration of the senior management.

The officers of the company which are covered by the remuneration policy are the managing director and other “senior management” (as a rule the members of the group executive board).

Regarding certain private placements of public limited companies (inter alia new issue, by the company or by a company within the same group, of shares, warrants or convertible instruments) there are since 1987 provisions in the Companies Act implying that the resolution on the placement always must be adopted or approved by the general meeting of the issuing company. Furthermore, the resolution must be adopted or approved by not less than nine-tenths of both the shares voted and of the shares represented at the general meeting. Regarding other remuneration schemes, e.g. schemes on the basis of share price movements, the provisions described above on the adoption of a policy apply.

According to the Swedish government bill, it is of great importance for building sustained investor confidence that listed companies display appropriate transparency on remuneration issues, and that listed companies enable shareholders to express their views in an efficient manner.

#### *The Annual Accounts Act*

Public limited companies and companies operating in financial markets shall disclose information on the total remuneration and other benefits, including pensions and severance payment agreements, granted to the board of directors and to the managing director, in the annual report. This obligation has recently been extended so that the information shall cover all of the company’s senior management (see the government bill mentioned above). In addition to this, the annual report shall disclose the remuneration of the individual members of the board of directors and of the managing director.

#### *Envisaged measures*

The legislation mentioned above are currently under review by two government commissions.

## **2. Codes of conduct**

#### *The Swedish Code of Corporate Governance*

On 1 July 2005, the Stockholm Stock Exchange began applying the Swedish Code of Corporate Governance. The Code applies to all Swedish companies listed at the Stockholm Stock Exchange and aims to improve the governance of Swedish companies, primarily to ensure that companies are run in the best interests of the owners.

The Code contains rules on executive management remuneration. According to these rules, The board is to have formal and clearly stated processes for deciding on remunerations to members of the executive management. It shall also establish a remuneration committee.

Members of the board are, according to the Code, not to participate in share and share-price related incentive schemes designed for executive management or other employees of the company. The decision of the shareholders’ meeting is to include all the principle terms of the scheme. Background material and documentation pertaining to the proposed scheme is to be made available to shareholders in good time before the shareholders’ meeting. The material is to be clear and simple enough to allow shareholders to form an opinion on the reasons for the scheme, the principle terms of the scheme and any dilution of the share capital that may result from it, as well as the total cost to the company of different conceivable outcomes.

### *Guidelines for terms of employment for senior executives in state-owned companies*

On 3 July 2008, the Government adopted new guidelines for terms of employment for senior executives. These guidelines replace the previous guidelines adopted in 2003. Reasonable remuneration is important for confidence in the business sector as a whole. Reasonable and well-considered remuneration to the senior executives is a key part of owner control in state-owned companies. It is important that boards deal with issues relating to remuneration to senior executives in a deliberate, responsible and transparent way and that the boards ensure that the total remuneration is reasonable.

In the same way as in the listed companies, the boards of the state-owned companies shall propose guidelines for compensation to senior executives for decision by the annual general meeting. The guidelines proposed by the board shall not be more generous than the Government's guidelines. The total remuneration to senior executives shall be competitive, with a set ceiling, reasonable and appropriate for its purpose. This remuneration shall not be wage leading in relation to comparable companies but shall be characterised by moderation. It is the responsibility of the entire board to decide on remuneration to the CEO. The board shall also ensure that the remuneration paid to the CEO and other senior officers is within the guidelines decided upon by the annual general meeting.

The CEO shall not be covered by any variable salary. The state-owned companies shall report remuneration paid to senior executives in the corresponding way to listed companies. This means that the state-owned companies shall comply with the special rules on reporting of remuneration to senior executives as well as bonus programmes applicable for stock market companies and public listed companies. These rules are mainly contained in the Swedish Companies Act (2005:551) and in the Annual Accounts Act (1995:1554). Among other things, it means that the board reports to the annual general meeting on whether previously decided guidelines have been complied with or not and the reasons for any non-compliance. Furthermore, the company auditors shall submit a written signed statement to the board before every annual general meeting as to whether the auditor considers that the guidelines applicable since the previous annual general meeting have been complied with or not.

### **3. Specific measures taken in the context of the national rescue packages for the banking sector**

#### *Requirements on executive compensation under the Guarantee Program for Medium-term Debt*

The Swedish government has in accordance with the Government Support to Credit Institutions Act (2008:814), adopted a guarantee program that provides government guarantees for debt securities. The program conforms with the guidelines adopted by the ECB and the European Council conclusions of October 16, 2008. The guarantee program is regulated in an Ordinance (2008:819) on Government Guarantees to Banks and others.

According to Section 9 of the Ordinance, credit institutions that wish to participate in the guarantee program have to sign an agreement with the National Debt Office that limits executive compensation for the five senior officers at the institution with the highest aggregate remuneration. The requirements are as follows during the term of the contract:

- a) fixed pay or other fixed remuneration to a particular officer may for the position in question not exceed the level of remuneration that had been decided prior to 20 October 2008,
- b) variable remuneration, may not be implemented, paid out, decided or earned during the term of the contract,
- c) severance packages shall not contain terms which are more favourable than the applicable guidelines for terms and conditions of employment of leading senior officers in enterprises under government ownership, and
- d) fees for members of the board and other remuneration for board assignments should be limited to a maximum of the level decided prior to 20 October 2008.

*Conditions for executive compensation in cases of recapitalization and other support*

In a separate Ordinance other types of support is regulated, such as recapitalization. The same kinds of requirements is used in such cases.

## **UNITED KINGDOM**

### **1. Legislation**

The **Directors' Remuneration Report Regulations (DRRR) 2002** require Quoted companies to publish a report on directors' remuneration as part of its annual reporting cycle.

The report must include:

- Current details of individual director's pay packages and justification of any compensation packages given in the preceding year;
- Details of the board's consideration of directors' pay:
  - Membership of the remuneration committee
  - Names of any remuneration consultants used, whether the remuneration appointed them independently, whether the consultants provide any other services to the company (and, if so, what these are);
- Details of the company's policy on directors' remuneration:
  - Details and criteria for long term incentive and share option schemes, including proposed amendments;
  - Explanation of balance between elements in packages which relate to performance and those which do not;
  - Details and explanation of policy on contract an notice periods.
- A performance graph providing information on the company's performance in comparison with an appropriate share market index.

Quoted companies are also required to table a resolution at each AGM on the whole remuneration report. This vote is advisory.

**New requirement April 2009:** Introduction of requirement for quoted companies to report on how the pay and employment conditions of employees were taken into account when determining directors' pay.

## **2. Codes**

The **Combined Code of Corporate Governance** includes principles and provisions on remuneration on a “comply or explain” basis. The Listing Rules require UK companies listed on the Main Market of the London Stock Exchange to describe their adherence to the Code's main principles, and explain non-compliance with the Code's provisions.

The main principles in regards to remuneration are that levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but that a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance. Remuneration is in Section B1 of the Code (p.13-15) on the following link:

[http://www.frc.org.uk/documents/pagemanager/frc/Combined\\_Code\\_June\\_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf)

In addition to the Code, there are also **guidelines by institution investor organisations**, such as the Association of British insurers' (ABI) guidance on executive remuneration, and the ABI/ National Association of Pension Funds joint statement on executive contracts and severance. These two can be found on the following links:

<http://www.ivis.co.uk/ExecutiveRemuneration.aspx>

<http://www.ivis.co.uk/ExecutiveContractsAndSeverance.aspx>

## **3. Measures related to national rescue packages for the banking sector**

The Government has agreed a range of **conditions with banks accessing the recapitalisation scheme**. The exact terms have been agreed on a case-by-case basis with banks accessing the recapitalisation scheme, although elements agreed to date are common to all participating banks. This include restricted remuneration of senior executives:

- **For 2008**, the Government expects no cash bonuses to be paid to board members. (For RBS and HBOS, there will be no board director bonuses in 2008. For Lloyds, there will be no board director cash bonuses, whereas stock bonuses will be permissible subject to prohibition on sale until 2009.)
- **For remuneration policy going forward**, compliance will be required with industry best practice, such as the ABI industry best practice code. The FSA has written to the major UK-based banks asking them to review their remuneration policies against a set of criteria for good and bad practice<sup>4</sup>. It is currently reviewing remuneration policies in the banks and in the early part of next year it will publish a review of its findings together with a more comprehensive assessment of what it considers to be good and bad practice. In addition, incentive schemes will be reviewed and linked to long-term value creation and take account of risk, and not short term indicators such as profits or revenues. Reward for board members will also take into account internal relative compensation packages and perceived fairness in the current economic climate. There will be no "reward for failure"; where a Board Member loses the confidence of the Board, they should be able to be dismissed at a cost that is reasonable and perceived as fair.

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<sup>4</sup> The DCEO letter can be found on the following link: [http://www.fsa.gov.uk/pubs/ceo/ceo\\_letter\\_13oct08.pdf](http://www.fsa.gov.uk/pubs/ceo/ceo_letter_13oct08.pdf)

## **EUROPEAN COMMISSION**

The Commission services are currently examining not only the issue of executives' remuneration but also remuneration structure problems in financial services. Work is at preliminary stage and an explanatory discussion with corporate governance experts is scheduled to take place next week.

The Commission services expect initiatives on these issues to be part of the "financial markets for the future" package scheduled for early 2009.