

Feedback

**of Deutsche Schutzvereinigung für Wertpapierbesitz e.V.
(DSW)**

to the

**EU Commission's draft Guidelines on the standardised
presentation of the remuneration report under Directive
2007/36/EC, as amended by Directive (EU) 2017/828, as
regards the encouragement of long-term shareholder en-
gagement**

DSW would like to congratulate the EU Commission for further developing the draft remuneration guidelines for executive and non-executive board members. The Commission has picked up important recommendations from the investor side, e.g., by including recommendations for reporting comparative figures for directors' compensation at group level. Although the draft guidelines have taken longer than foreseen, we urge the Commission to adopt them as soon as possible, as they would support the comparability of directors' remuneration between Member States, which is currently lacking.

DSW would like to add the following recommendations to further enhance the understandability and readability of the guidelines for the intended audience, i.e. mainly the shareholders but also other stakeholders.

General remarks

- Regarding Article 9a and 9b, SRD II has been implemented by the majority of member states already in 2020. Since then, a certain level of standardisation has emerged. We therefore encourage the EU Commission **to remain sufficiently ambitious in their disclosure recommendations and not to fall back behind what is already legally required or best practice standard at national level**. We point for example to the disclosure of ex-post performance conditions (section

6.5, no. 3). The guidelines consider their disclosure just as a suggestion ('could'). The same is true for the disclosure of the level of discretion exercised in respect of an award (section 6.5, no. 6 (4)) or the disclosure of the reasons for having reclaimed remuneration during the reporting year (section 6.4, no. 2). In Germany, the disclosure of all these elements is already either required by law or recommended by the German Corporate Governance Code and it is important for shareholders to understand whether the company's directors' performance indeed has followed the pay-for-performance principle and how it contributes to the company's sustainable and long-term performance. As the guidelines are already non-binding, we therefore ask the Commission to **consider strengthening the reporting requirements** in that respect.

- The **design of the remuneration guidelines is not consistent with the structure standards across numerous member states**. While the guidelines foresee the presentation of all directors within one document (albeit tables may be separated for executive and non-executive directors), remuneration reports in the EU currently predominantly publish executive and non-executive directors' remuneration in separate sections of the report. This structuring is reasonable as executive and non-executive directors' remuneration differs significantly both regarding its elements but also regarding its respective purpose.

While executive directors' remuneration is (ideally) mainly dependent on the (financial and non-financial) performance of the company, the remuneration for non-executives is (ideally) not linked to the company's performance but considered as a compensation for independent supervising services. While the former consequently includes variable remuneration elements (cash or share-based), the latter does not in most member states. We therefore recommend that the Commission **adapts the structure of the remuneration guidelines** so that issuers are able to comply with the disclosure practices of both national and EU disclosure requirements.

- Remuneration reports nowadays are often very complex. We therefore welcome that the Commission recommends that issuers present the remuneration report as a **stand-alone doc-**

ument, containing all necessary information in one place (section 5.4). We strongly recommend, however, to also recommend that issuers **integrate not only the key features but the complete remuneration policy** in the remuneration report. The remuneration policy, unlike the remuneration report, has to be approved by shareholders at least every four years, according to SRD II and some member states have indeed made use of the option to extend the frequency to that maximum time span, e.g., Germany. Consequently, it will not be part of the agenda of a shareholders' meeting annually. Where it is not included in the annual report (this for example is not required by German law), shareholders will have to search for it on the company website which is a rather cumbersome exercise. As not all information necessary to understand the information of a director in a given financial year is recommended to be included in the remuneration report by the guidelines (e.g., performance conditions for share-based incentive plans), the separation of the policy and the report risks that important information to assess the 'pay for performance' will not be easily accessible for shareholders.

In addition, we point out that Article 9b (1) (a) of SRD II requires member states to ensure that the remuneration report contains information about how the total remuneration complies with the adopted remuneration policy. Leaving it to companies to decide what is considered to be the key features of the remuneration policy may result in the exclusion of important elements for certain stakeholders (e.g. non-financial performance conditions that form only a minor part of the overall compensation package) on grounds they would be deemed of lower importance by the company.

Moreover we would welcome if the Commission recommended that **issuers make use of graphs or charts to enhance readability** of remuneration reports, especially with regard to short- and long-term remuneration components. As a minimum, it would be preferable to provide a structured overview of the remuneration policy at the beginning of the report (in the introduction). Cross-referencing in the report should only apply to specific cases and we advise to prevent it as much as possible.

- There is a **need for more guidance on the terms 'awarded', 'due', 'granted', 'offered' and 'vested'**. The discussion at the hearing held on 28 September 2022 has shown that understanding of these terms still differs among practitioners and academics. We support the idea to **make use of examples** to enhance understanding and to improve the definitions included in the guidelines. In addition, we would like to ask the Commission to **ensure that there is no time lag in disclosure of remuneration**: investors should be enabled to compare the performance of a company in a given year to the evolution of the remuneration for that same year. For the short-term incentive, it is therefore necessary to clarify that the remuneration for the financial year under review (even if paid out only in year+1) is the remuneration that needs to be reported according to the remuneration guidelines.
- We note that the Commission uses the terms 'shall', 'should', 'could' and 'may' to stagger the nature of the disclosure recommendation and enhance flexibility for reporting issuers. We remind the Commission that the guidelines are already non-binding. We would therefore **consider it helpful if the guidelines were framed in such a way that they only contain 'shall' recommendations** in order to avoid further confusion in the markets and enhance comparability for shareholders. In any case, we suggest adding a **glossary** explaining readers the difference between the various terms used in the guidelines.
- We consider it sufficient for the guidelines to **apply as of financial (reporting) year 2023**. Companies will have to adapt their remuneration reports again within a relatively short period of time and should be enabled to develop a disclosure that is designed to enhance transparency.
- We ask the Commission to consider **rewording the transitional regime** (section 8) to state clearer that remuneration figures as of financial year 2020 are recommended to be disclosed by the guidelines. With the exception of comparative figures required in table 5, figures from financial year 2020 onwards should now be available at the large majority of European issuers as SRD II had come into force in many member states already.
- Taking note of the discussion at the hearing on 28 September 2022 regarding the alignment of the remuneration guidelines'

wording with that of CFDR in respect of 'sustainability' information we point out that the term 'sustainability' is narrower than the term 'non-financial' which could exclude some targets. We therefore recommend **keeping the term 'non-financial'** in the guidelines.

Specific recommendations relating to certain elements of the guidelines

Scope of application

The scope of application includes "*(i) any member of the administrative, management or supervisory bodies of a company; (ii) where they are not members of the administrative, management or supervisory bodies of a company, the chief executive officer and, if such function exists in a company, the deputy chief executive officer; and (iii) where so determined by a Member State, other persons who perform functions similar to those performed under point (i) or (ii)*".

This **scope seems too narrow** given the already existing practice in certain member states to reduce the Board of Directors to the CEO and non-executive directors, meaning that other executive functions, like e.g., the CFO, will have its original role but not fall within the scope of application of the guidelines because they are performing their roles as members of an executive committee.¹

Table 1

- To understand the evolution of the company and its performance it is inevitable for shareholders to understand the evolution of year over year remuneration. In addition, this information is available at the company and the burden to find comparative figures should not be placed on shareholders. We therefore strongly advise the Commission to **recommend the disclosure of year-1 figures in table 1**.
- We would like to receive clarification in which row '**pension equivalents**' – which are becoming more and more popular in Germany – should be included. Would the Commission consider these as 'other benefits' or as 'pension benefits'? In addition,

¹ <https://www.airbus.com/sites/g/files/jlcbta136/files/2022-03/AIRBUS%20FY2021%20FINANCIAL%20STATEMENTS%20DS.pdf>

we would like to receive clarification on what information exactly should be provided in the row '**pension benefits**'. Specifically, in section 6.2 no. 5 (4), disclosure of 'contributions and provisions' is recommended while later in the same paragraph, disclosure of 'service cost and interest cost' is recommended. From our understanding, the terms have different meanings. From an investor perspective, it would be welcome to receive the complete picture of pension provisions provided to directors.

- Furthermore, we would like to receive clarification what is understood by the term '**fees**'. The explanatory notes regarding table 1 (section 6.2, no. 5) seem to suggest that this should only cover meeting fees ("*all fees and allowances of the director for the participation in the administrative, management or supervisory bodies of the company meetings during the reported year*"). We would like to point out, however, that in certain member states, for example in France, the positions of chairman and CEO are not always split. A CEO would therefore also receive compensation for his/her chairmanship on the Board of Directors the disclosure of which would go beyond the mere meeting fees. We consider that this kind of information should also be included in the report to present a complete and concise picture of the overall amount received by a director.
- In addition, we would like to receive further guidance on what is understood by the term '**former director**', especially for how long a former director's remuneration needs to be disclosed. In Germany, disclosure is required for ten years following the year of leaving office and is provided in a separate section of the remuneration report.
- We note that the **proportion of fixed and variable remuneration** shall be calculated by a predetermined formula included in the explanations to table 1 (section 6.2 no. 5 (6)). We would like to point out that the outcome of the calculation cannot be scrutinised by shareholders due to pension benefits to be solely displayed as a total figure, whereas the calculation asks pension benefits to be broken down into their variable and fixed part.

Tables 2 and 3

- As regards the disclosure of **information on share-based remuneration** (section 6.3) we would like to point out that this **does not seem to cover performance cash plans**, for which no market value or fair value exists. Likewise, we would like to receive clarification whether restricted share plans are covered by section 6.2 no. 4. **For performance cash plans, the target value of a plan needs to be disclosed.** We would therefore like to suggest that tables 2 and 3 are being reviewed in order to make them applicable to any kind of long-term remuneration, be it share- or cash-based.
- In addition, we consider it important that in section 6.3 no. 5 it is **recommended to disclose the fair value of shares along with the market value.** The fair value is required by IFRS 2 and we would welcome if the remuneration report mirrored the reporting requirements foreseen in the financial statements.
- From the explanatory notes it is not clear to us, whether the **performance conditions and their achievement** – if applicable for long-term compensation plans – are recommended to be disclosed or not according to the remuneration guidelines. This information, where available (depending on the design of the plan), is however necessary to understand the evolution of a director during the year under review.

Information on how the remuneration complies with the remuneration policy and how performance criteria were applied

In section 6.5, no. 3, the guidelines recommend that companies *"should present for each director a description of the financial and sustainability performance criteria (such as, where appropriate, environmental, social, human rights criteria) as included in the applicable remuneration policy for the different elements and types of remuneration, the performance achieved over the reported financial year and the outcome of the remuneration resulting from each criterion."*

Firstly, we suggest **amending the wording in section 6.5 no. 3**, from *"environmental, social, human rights criteria"* to *"environmental, social, and governance criteria"*, to reflect standard language in that respect.

Secondly, we would like to underline that disclosure of performance criteria and the performance achieved against each performance criterion is key for shareholders to understand whether pay followed performance during the financial year. Given the increased importance of sustainability performance criteria and the fact that their assessment is still more difficult than for financial performance criteria, we welcome that these have been explicitly mentioned in the guidelines.

However, as already stated elsewhere in our reply, we are concerned that the **ex-post disclosure of performance targets is designed as a 'could' recommendation**, having even less impact than a 'should' recommendation, according to our understanding. In that respect, we strongly suggest **adding a reference in the guidelines that performance criteria 'should' be disclosed ex-post**. Moreover, we strongly recommend that such guidelines' section **explicitly mentions the disclosure of ex-post achievement of sustainability performance criteria**, notably environmental, social and governance performance criteria together with their proportion in the variable remuneration. Given that the EU Commission's Green Deal is aiming at setting out the trajectory for the EU to be climate neutral by 2050, steering this transition by designing remuneration packages for executive directors with a distinct share of sustainability targets is key and information on the share of sustainability targets that are expected to support this aim is needed by shareholders and other stakeholders.

Table 4

We would like to point out that this table seems to relate only to the remuneration awarded or due, i.e. the remuneration paid during the year under review. This means that **for remuneration granted (which is disclosed in tables 2 and 3), information on minimum, target and maximum values will not be available to shareholders**. We suggest **extending the reporting recommendation** in that regard to ensure that shareholders receive the complete picture about minimum, target and maximum awards granted during the year under review.

In addition, we wonder whether disclosure of target remuneration (at 100% fulfilment of target) is recommended to be included in this table. To assess the performance of executive directors during a given year, it is important to understand whether they were able to outperform the targets set by the (supervisory) board or

whether they have underperformed. We therefore recommend **providing guidance that the target remuneration at 100% fulfilment of predetermined targets is indeed recommended** to be included in table 4.

Table 5

The annual change, if disclosed in percentages only, has not been proven to be meaningful information to investors, at least not in Germany. A better and more precise way to show the annual change of directors' remuneration is to **additionally present the absolute remuneration amounts**, if necessary, accompanied by notes or the date of entry/exit to the board. In particular, changes to the board lead to distortion in the relative figures, which could best be solved by providing shareholders with the absolute amounts of remuneration combined with information on the exit and entry dates of a certain director.