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REMUNERATION POLICY: SHARING COMPETENCE BETWEEN THE BOARD OF DIRECTORS AND THE SHAREHOLDERS

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Executive pay in listed companies has become a major issue for investors. Indeed, substantially improved disclosure on remuneration policy has brought to light situations that fall far short of international best practice.

Given the potential cost of excessive remuneration, shareholders have a legitimate interest in asking to be allowed to express their opinion on the matter. It therefore seems reasonable to allow the Annual Meeting of shareholders to cast an advisory vote on remuneration policy, with the Board of Directors retaining competence and responsibility for setting pay at individual level.

More information on Executive Remuneration Policy:

- « **Remuneration Policy** », Ethos' voting guidelines, chapter 4, January 2007
- « **Executive remuneration - Guidelines on policies and practices** », Association of British Insurers, December 2006
- « **Executive Remuneration in the 100 Largest Companies listed in Switzerland** », Ethos Study, November 2006

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- Neue Zürcher Zeitung (18.4.2007)
- Le Temps (25.4.2007)

DISCLOSURE: NECESSARY BUT NOT SUFFICIENT

In the past few years, the adoption in several countries of stricter rules on pay disclosure has led to substantial improvement in the quality and amount of information provided to shareholders, often revealing excessive remuneration patterns. In the face of such excess, it has unfortunately become clear that disclosure must be accompanied by a right for the shareholders to oversee the basic principles and mechanisms underpinning the executive pay policy of listed companies.

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This requirement figures in the “Principles of Corporate Governance” published by the OECD (of which Switzerland is a member) in 2004: “Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.”

Several countries have thus gradually adopted rules giving shareholders some say on remuneration policy. The first country to require the annual meeting of shareholders to cast an advisory vote on the remuneration report was the United Kingdom, in 2002. Since then, several other countries have introduced an advisory (Australia) or binding (Netherlands, Sweden) vote. In France, the shareholders are required to approve the Directors’ attendance fees. In the United States, they vote on all share based plans. In addition, the House of Representatives, by a historic vote of 269 against 134 held on 20 April 2007, approved legislation requiring public companies to submit their remuneration policy to an annual advisory vote of the shareholders. The bill has to be approved by the Senate and signed by the President before it enters into force.

In all countries where shareholders have a say on executive pay, the Board of Directors, or its remuneration committee, has become particularly attentive to the views of the shareholders, especially institutional shareholders. In the United Kingdom and the Netherlands, for example, this has resulted in more challenging performance targets for the exercise of stock options. Generally speaking, allowing the shareholders to make their views known has helped to dampen the exponential growth in pay observed in the past few years and to align remuneration with company performance.

REVIEW OF THE SWISS CODE OF OBLIGATIONS: AN OPPORTUNITY TO SEIZE

In Switzerland, executive pay in listed companies is also a much debated issue. In 2002, when the *economiesuisse* Code of Best Practice for Corporate Governance and the SWX Corporate Governance Directive were published, all the parties concerned (companies and shareholders) hoped that simple recommendations relating to the composition of the remuneration committee and pay disclosure would suffice to prevent excesses. Unfortunately, it soon became clear that this did not stop some companies from offering executives egregious pay packages.

Some legal scholars contend that shareholders who are unhappy with the remuneration system should simply oppose the discharge of Board members. Unfortunately this in no way helps improve the company's pay practices! Another possibility is to oppose the re-election of the members of the remuneration committee, at present often the only option open to disgruntled shareholders. The objective nevertheless remains to give shareholders a direct say on the remuneration policy itself.

In this respect, not all hope is lost. The draft revision of Swiss Company Law (the Swiss Code of Obligations) being prepared by the Swiss Federal Department of Justice provides an opportunity to introduce a reasonable division of responsibility for pay between the Board and the shareholders.

ADVISORY VOTE OF SHAREHOLDERS

The Federal Council's preliminary draft proposes adding to Article 627 (which specifies the provisions that are valid only if included in the Articles of Association) the competence of the shareholders' meeting regarding remuneration. At present, it is nevertheless often illusory to believe that a Board will of itself propose to include in the Articles of Association the possibility for the shareholders to have a say on remuneration policy, especially if the remuneration policy is not in line with best practice. Therefore, it is left to the shareholders to propose, via a shareholder resolution, the inclusion of such a provision in the company's Articles of Association. However, the resolution would have to garner over 50 per cent of votes to enter into force. This is therefore not a satisfactory solution.

A better solution would be to give the shareholders' meeting direct competence regarding the remuneration policy by adding a paragraph to Article 698 of the Code of Obligations. The objective being to share responsibility, a compromise solution would be to give the shareholders an advisory vote on the remuneration policy alone. It is important to specify that the shareholders' meeting would not be mandated to approve individual pay, only the remuneration policy. In this way, the Board of Directors would keep the responsibility for determining the individual pay packages both of the executive management and of the members of the Board of Directors.

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- **The Ethos Foundation** was created in February 1997 by two Geneva-based pension funds and is currently composed of 75 institutional investors. Its purpose is to promote the consideration of sustainable development principles and corporate governance best practice in investments activities.
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