Executive Remuneration in the EU: Comparative Law and Practice

Law Working Paper N°. 09/2003
June 2003

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ECGI Working Paper Series in Law

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*Part B of this paper is based on the answers given to a questionnaire on the national laws relating to directors' remuneration in the EU. We are grateful to Ingalill Aspholm, Paulo Câmara, Jan Schans Christensen, Daniel Dax, Alessandra De Cantellis, Sonja D'Hollander, Jesualdo Domínguez-Alcahud, Diego Escanero, Jose M. Garrido, Steven Hijink, Susanne Kalss, Björn Kristiansson, Marco Leonardi, Jacques Loesch, Evanghelos Emm. Perakis, Markus Roth, Joëlle Simon, Kelley Smith, Georgios D. Sotiropoulos, João Sousa Gião, Tiina Visakorpi, Anne Wilschut, Eddy Wymeersch and Andrea Zanoni for either answering or reviewing the answers to the questionnaire. The full text of the answers will be downloadable at http://www.ecgi.org.

Abstract

Executive pay practices are currently a 'cause célèbre' of corporate governance in the media, among regulators, in the marketplace, and in academia, in the US, the UK, and Europe. The purpose of this paper is to examine the approaches taken across Europe to the regulation of executive pay practices in listed companies. The outstanding feature of the regulation of executive pay across Europe is the extent to which it reflects the interconnection between pay and corporate governance. This link is expanded on in Part B with respect to the different rules found across European legal systems and how they address/prioritize the concerns which executive pay potentially raises. The role of public regulation is relatively important for disclosure of executive pay, while best practices and private codes generally have some impact on the way in which executive compensation is set for listed companies. On the whole, there is some convergence in continental Europe towards the Anglo-American model. The merits of full disclosure of executive remuneration are increasingly acknowledged in corporate governance codes and reports, while the use of remuneration committees is on the rise in the Continent.

The research data on reported pay practices for 2001 among FTSE Eurotop300 companies reveal a reliance on performance-based pay generally and a somewhat variable adoption of share options programmes and other equity-based incentive contracts, which are generating difficulties in dispersed ownership systems. The executive pay problem may therefore be a particular cost of dispersed ownership, and the particular legal and policy responses, which are widely debated a specific feature of Anglo-American corporate governance. Nonetheless, the faultline between both systems, which is evident from the different approaches European states have taken, calls for particular care in the adoption of pan-European reforms but also in the transplanting of reforms based on the Anglo-American experience.

Keywords: Executive pay, Corporate governance, Ownership structure, Company disclosure, Remuneration Committee

JEL Classifications: G3, G38, J33, K22

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A Theoretical Background: Executive Pay as a Function of Governance Structures

1.1 Introduction

Executive pay practices are currently a *cause célèbre* of corporate governance in the media,[1] among regulators,[2] in the marketplace,[3] and in academia,[4] in the US, the UK, and Europe. This development coincides with popular unease with levels of executive pay.[5] Executives are now paid at very high levels due, for the most part, to a dramatic increase since the early 1990s in equity-based performance-linked pay and, in particular, the use of share options. Recent experience in the UK also reveals a deep concern with "rewards for failure" or the compensation payments made on termination of directors' service contracts, particularly where these contracts extend over a number of years.[6] The argument that high levels of executive pay reward corporate performance and are set by market dynamics is not, however, always compelling.[7] In particular, the US pay model, which has generated, via its emphasis

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[1] On May 20 2003, eg, the UK *Independent* produced a special supplement on executive pay.

[2] See the reforms introduced in the UK in 2002 which require considerably greater disclosure on executive pay practices as well as a non-binding shareholder vote on pay. In Germany, moves are afoot to force more extensive disclosure of individual directors' pay: B. Benoit, "German executives may be forced to publish salaries" *Financial Times,* May 20 2003.

[3] See the International Corporate Governance Network's report on executive pay which sets out its approach to effective pay structures and pay-setting procedures: ICGN, "The Caucus Race", July 2002.

[4] There is a vast, predominantly US-based, empirical literature on the effectiveness of pay structures. See, e.g.: K. Murphy, "Executive Compensation" in O. Ashenfalter and D. Card (eds.), *Handbook of Labor Economics* (Elsevier, 1999) 2485 and L. Bebchuk, J. Fried, and D. Walker, "Managerial Power and Rent Extraction in the Design of Executive Compensation" 69 U. of Chic. LR. 751 (2002).

[5] The rejection of the GSK Remuneration Report dominated the press, radio, and television media and led to widespread condemnation of rewards for failure in the UK. See, eg, the May 20 2003 editorials in the *Independent* ("A vote that marks the beginning of the end of rewards for corporate failure") and the *Financial Times* ("Parachute holed: GSK must respond to shareholder concerns on executive pay").

[6] See the UK Department of Trade and Industry's Consultation Document, ""Rewards for Failure" - Directors' Remuneration - Contracts, Performance, and Severance", June 2003.

[7] In 2000, for example, 85% of corporate leaders received the maximum bonus, 40% received long term pay outs for median performance, and 43% were awarded options plans for meeting growth targets of only 2-3%

on options, often stratospheric payouts to executives who have reaped huge rewards from the long bull market run of the 1990s, is coming under harsh review in the face of striking evidence of poor corporate performance in a post Enron/Worldcom economic environment.[8] Similarly, the market dynamic argument can be countered by governance weaknesses in contract negotiation which generate a deeply conflicted pay process, and inefficiencies in the market for information on pay, which seem to allow executives to control their own pay.

The purpose of this paper is to examine the approaches taken across Europe to the regulation of executive pay practices in listed companies. In order to expose the faultlines of the debate on pay, and to track the approach taken by European legal systems to the core questions it raises, Part A briefly outlines the main features of the pay controversy. That debate has three elements: structure; governance; and disclosure. While the particular structural problems raised by pay are not generally tackled by European legal systems (an approach followed by the European Commission in its Action Plan on Company Law presented on May 21),[9] governance and disclosure are addressed, in varying degrees according to the governance system in operation, in most European countries. The outstanding feature of the regulation of executive pay across Europe is the extent to which it reflects the interconnection between pay and corporate governance. Executive pay, regarded as a performance-based incentive contract, is a key agency-cost control mechanism in dispersed ownership systems. Legal controls on pay are accordingly at their most sophisticated, in terms of seeking to ensure the adoption of an optimal contract for shareholders, in those European countries where dispersed ownership dominates. In systems characterized by blockholding, controlling shareholders can, in theory, monitor management directly without the need for an incentive contract. Pay controls are accordingly less sophisticated (and the prevalence of high-powered, equity-based incentive contracts reduced: see I.2.3 below). Concerns arise, however, as to the protection of minority shareholders.

A shift to more pervasive equity ownership across Europe in the wake of the Financial Services Action Plan may bring with it the structural, governance, and disclosure problems currently associated with pay practices in dispersed ownership systems. European executive pay cannot, however, be regarded in a monolithic fashion given the current sharp differences in corporate governance as well as diverging cultural attitudes towards wealth and pay transparency.

1.2 The Agency Model of Executive Pay: Implications for Dispersed Ownership and Blockholding Systems

1.2.1 Dispersed Ownership

The current debate over the appropriateness of current structures and levels of executive pay, which is particularly a feature of dispersed ownership systems,[10] is characterized by the

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above inflation: Andersen Directors' Remuneration Report, September 2001, cited in O. Gadiesh and M. Blenko, "The Weapon of Executive Pay" *Financial Times*, November 27 2002.

[8] Reference is made to the "discredited" share-option-driven US model in "An executive pay package too far" *Financial Times*, November 22 2002.

[9] Commission Communication on Modernising Company Law and Enhancing Corporate Governance in the European Union: COM (2003) 284, para 3.1.3.

[10] Although the European debate is not confined to the classic dispersed ownership systems. French shareholders, and particularly minority shareholders, are expressing concerns as to executive pay. See J. Johnson, "France Inc closes ranks on dispirited rebel investors" *Financial Times*, May 26 2003.

number of differing approaches to pay. Executive pay can be placed in the traditional legal paradigm of the company as a single entity to which directors owe fiduciary duties, including duties not to engage in self-dealing and to avoid secret profits. More generally, it can be regarded as a wealth transfer question, with the law cast as a mechanism for curbing executive excess.[11] There is also the argument that executive pay in itself is not a problem: it is simply the outcome of a wider failure to address defects in corporate governance in dispersed ownership systems, particularly with respect to board passivity.[12]

The dominant model for executive pay in the dispersed ownership context, however, is the principal/agent incentive model. This model generates two competing characterizations of executive pay. The first justifies executive pay as a remedy for the agency costs generated by the misalignment of management and shareholder interests in the dispersed ownership company. As is well known, in such companies shareholders have only a fractional interest in firm profits, are not incentivized individually to a significant extent to discipline management, and have limited opportunities to observe management's actions. Management's unobserved actions, particularly privately beneficial activities such as the taking of perquisites can have a considerable bearing on shareholder wealth and give rise to agency costs.[13] Whether, and the extent to which, a manager will fully pursue the shareholders' wealth maximization agenda rather than his or her own depends on how that manager is incentivized to maximize shareholder wealth. The performance-based pay contract, which links pay to shareholder wealth via performance indicators such as share prices or accounting-based targets, provides a powerful way of incentivizing managers to pursue the shareholders' agenda.[14] Share options and equity-based pay provide the most direct performance link to shareholder wealth, expressed via the share price. Although the earlier empirical evidence suggested that pay was not linked to performance, more recently a closer correlation has been found in the US between remuneration and performance.[15] Another US study has shown that shareholders gain from a positive market reaction on the announcement of performance-linked pay plans,[16] while a positive relationship has been found between firm performance and the percentage of equity held by managers and the percentage of their pay which is equity based.[17]

There is, however, a second way of examining pay under the principal/agent model: it can be seen as an agency cost in itself which may require regulatory intervention. As pay is set by the board on behalf of the shareholders, and as it is not a neutral arbiter (see I.3 below), pay contracts can be regarded as, potentially, not the outcome of adversarial arms' length bargaining between shareholders and management seeking to maximize their interests. Instead, they may give scope to executives to influence pay and extract "rents" in the form of

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[11] M. Loewenstein "Reflections of Executive Compensation and a Modest Proposal for (Further) Reform" 50 Southern Methodist U. LR. (1996) 201.

[12] C. Elson, "The Duty of Care, Compensation, and Stock Compensation" 63 U. Cinn. LR. (1995) 649, 651 and 661.

[13] R. Aggarwal and A. Samwick, "Executive Compensation, Strategic Competition, and Relative Performance Evaluation: Theory and Evidence" 54 J. Fin. (1999) 1999.

[14] M. Conyon and D. Leech, "Top Pay, Company Performance and Corporate Governance" 56 Oxford Bulletin of Economics and Statistic (1994) 229, 230.

[15] B. Hall and J. Liebman, "Are CEOs Really Paid Like Bureaucrats" NBER Working Paper Series, Working Paper No. 6213 (1997) 1, 5. Similarly, the *Financial Times* has reported on research by Deutsche Bank which showed that CEOs with better incentives do deliver better value for shareholders: Lex, "Executive Pay" *Financial Times*, October 12/13 2002.

[16] A. Morgan and A. Poulsen, "Linking Pay to Performance" 62 J Fin. Econ. (2001) 489.

[17] H. Mehran, "Executive Compensation Structure, Ownership, and Firm Performance" 38 J Fin. Econ. (1995) 163.

pay in excess of that which would be optimal for shareholders.[18] Agency theory is also weakened in that it does not grapple effectively with the perverse incentives which performance-based pay can generate to manipulate share prices and earnings over the short term, as appears to have happened, to catastrophic effect, in Enron.[19]

1.2.2 Blockholding Governance

The agency-driven incentive model is at its most powerful in the dispersed ownership context. Executive pay takes on a different complexion in the context of relationship-based corporate governance characterized by concentrated shareholdings and long term shareholder commitment. A wide-ranging study of corporate control in Europe has recently concluded that there is a very high concentration of control among continental European companies.[20] In Germany, for example, more than 50% of all listed companies are controlled by a single majority block and only 17.4% are without a blockholder with a veto power. Overall, in 50% of non-financial listed companies in Austria, Belgium, Germany, and Italy, a single blockholder controls more than 50% of the voting rights. By contrast, the average blockholder in the UK controls 9.9% of votes, while in the US the average blockholding for NYSE and NASDAQ companies is 5%. Concentrations of direct voting power by shareholders in continental companies are intensified into blockholdings and control groups by cross shareholdings between dominant blockholders, the exercise of control through complex pyramidal ownership structures which allow control to be exercised through cascades of companies, proxy voting by financial institutions connected to the company, and voting pacts. While family shareholdings form a significant component of continental blockholdings, bank influence remains pronounced. This concentration of control, and the close relationship between blockholding shareholders and between shareholders and management, recasts the management-monitoring agency problem, which executive pay, in dispersed ownership systems, is designed to resolve. Blockholding shareholders should wield sufficient influence and power to access information on performance and on operations to control management. They should also be motivated to do so in that they suffer less from the collective action problem faced under the dispersed ownership governance model.

1.2.3 Empirical Evidence

The link between pay and governance, which is further discussed in Part B, and the consequent danger in regarding European pay practices as a coherent whole in terms of developing reform responses, is borne out by the varying extents to which high-powered, equity-based incentive contracts have extended into Europe. Equity-based performance pay increasingly forms part of UK pay structures.[21] The alternative monitoring mechanism

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[18] Bebchuk *et al* note 4.

[19] See, eg, J. Gordon, "What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections", Columbia Law School, Center for Law and Economics, Working Paper No. 203 (2002) and J. Coffee, "What Caused Enron? A Capsule Social and Economic History of the 1990s", id, Working Paper No. 214 (2003).

[20] F. Barca and M. Becht (eds.), *The Control of Corporate Europe* (OUP, 2001).

[21] Share option awards became initially popular in the UK post-1984 and grew dramatically until the early 1990s when the focus shifted to performance-driven Long Term Incentive Plans: B. Main, "The Rise and Fall of Executive Share Options in Britain" in J. Carpenter and D. Yermack (eds.), *Executive Compensation and Shareholder Value* (Kluwer, 1999) 83, 84 and M. Conyon and K. Murphy, "The Prince and the Pauper: CEO Pay in the United States and in the United Kingdom" 110 Econ. J. (2000) F640, F649. There are, however, large

provided by controlling shareholders seems, however, to have limited the degree of reliance on high-powered equity-based contracts in continental Europe,[22] although equity-based performance pay is used. The research data on reported pay practices for 2001 among FTSE Eurotop 300 companies, included in Part C of the present paper, reveal a reliance on performance-based pay generally (although company disclosure does not reveal the breakdown of equity-based components and the conditions attached) and a somewhat variable adoption of share options programmes. In France, of the 42 French Eurotop companies, 40 have adopted share option programmes while 47% of CEO pay and 49% of executive pay is variable or performance-related. Similar patterns are seen in Italy where 25 of the 44 Eurotop companies operate share option programmes, while 35% of CEO pay (only figure available) is performance-based. In Germany, of the 30 Eurotop members 17 have share option programmes while 7 operate long term incentive plans: 53% of all executive pay (including CEO pay) is performance-related. In the Netherlands 17 of the 18 Eurotop companies operate stock option plans, with 31% of CEO pay and executive pay being performance-related. Finally, in Sweden, 16 of the 19 Eurotop companies operate stock option plans while 30% of CEO pay (only figure available) is performance-related. The difference with US pay is striking: one review has reported that, for a typical US CEO, the basic pay package (excluding variable/performance elements) is higher than the total package in Germany, Spain, Sweden and Switzerland.[23] While there is some evidence, therefore, of a link between pay and performance, it is much less clear that European boards are adopting the high-powered, equity-based contracts which are generating difficulties in dispersed ownership systems.

1.3 The Problems Generated by Pay Practices

1.3.1 Introduction

Part of the appeal of the incentive-driven, equity-based pay model lies in its simplicity and the degree of abdication it appears to permits of regulators. It does, however, present myriad problems in terms of structure, governance, and disclosure, discussed below, which may require regulatory intervention and which may, ultimately, be imported into blockholding systems if European systems embrace dispersed ownership more fully. Indeed, as discussed in Part B, some convergence in legal responses is emerging, particularly with respect to the centrality of controlling conflicts of interest in pay-setting and the importance of disclosure.

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divergences in CEO pay between the US and UK as a result of the differing use of options. Share options represent a smaller percentage of CEO pay in the UK (in 2002, 24%) than in the US (in 2002, 58%), while average US CEO compensation is $ 2.5 million as compared to $1.5 million in the UK: Hay Group (mid 2002) Study cited in cited in M. Skapinker, "After Garnier: Why executive rewards in the US and the UK are unlikely to converge", *Financial Times* May 21 2003.

[22] For evidence from Italy that the presence of strong shareholders tends to decrease the likelihood of high-powered incentive contracts being adopted see G. Brunello, C. Graziano, and B. Parigi, "Executive Compensation and Firm Performance in Italy" 19 Int'l. J. Industrial Organization (2001) 133 and, for a similar perspective from Spain, R. Crespi and C. Gispert, "Board Remuneration, Performance and Corporate Governance in Large Spanish Companies" SSRN (1998).

[23] Towers Perrin Worldwide Remuneration Survey (2000), reported in M. Becht, P. Bolton, and A. Röell, "Corporate Governance and Control", ECGI Finance Working Paper No. 02/2002, October 2002, 97.

1.3.2 Structure

The structure of equity-based pay reveals a number of inherent inefficiencies which seem to damage the performance link and the incentive mechanism which justify high levels of pay. In particular, structural difficulties with equity-based pay *per se* heighten the need for effective governance and disclosure in pay-setting. Much of the evidence, particularly with respect to share options, is US-based. Nonetheless, the structural difficulties raised by equity-based pay potentially represent problems for the UK given the internationalization of the market for executives[24] (although equity-based awards are more closely linked to performance as a result of the Combined Code) and, if dispersed equity ownership becomes more prevalent, continental Europe. This discussion highlights two difficulties: proxies for firm performance; and the problems raised by share options. Other structural weaknesses in pay practices include service contracts of over one year and the related phenomenon of contractually guaranteed "golden parachutes" which can amount to rewards for failure.

(a) Proxies for Firm Performance

The choice of indicator or performance standard is a complex one. At a minimum, however, the standard chosen should be sufficiently robust such that it can withstand manipulation by management. Share price is ordinarily the best available proxy for shareholder wealth. Difficulties with share prices include, however, the danger of incentivizing management to inflate earnings and manage disclosure to generate short term share price increases. Equity-based compensation also carries the danger of over-compensation of executives who preside over a period of market growth and under-compensation of those who are caught in a down market cycle. It is, however, difficult to construct a better alternative for shareholder wealth given that it does reflect the market's perception of the company's current and future cash flows, and so its perceptions of management performance and investment opportunities.[25] The risk of management inflating the share price, however, demands that the governance matrix, whether it be independent directors, institutional investors, or controlling shareholders, which monitors management and supports pay-setting, is robust.

(b) Share Options

Incidence

Much of the increase in executive pay, particularly with respect to US pay, can be attributed to the explosion in share option grants[26] over a period of stock market growth which massively increased the value of executive options.[27] As outlined in 1.2 above, while equity-

[24] B. Cheffins, "Will Executive Pay Globalise Along American Lines?" 11 Corporate Governance (2003) 8.
[25] K. Murphy, "Politics, Economics, and Executive Compensation" 63 U. Cinn. LR (1995) 713, 722.
[26] Senior US executives receive approximately 58% of their pay in the form of options: Hay Group mid-2002 Study note 21. There has also been an increase in grants initially valued at more than US $10 million: R. Thomas and K. Martin, "The Determinant of Shareholder Voting on Stock Option Plans" 35 Wake Forest LR (2000) 31, 35. See also B. Hall, "A Better Way to Pay CEOs" in J. Carpenter and D. Yermack (eds.), *Executive Compensation and Shareholder Value* (Kluwer, 1999) 35 who notes the 700% increase in the value of awards between 1980 and 1994 (at 35).
[27] One commentator has noted that almost 100% increases in the major stock market indices between 1995 and 1997 resulted in "executives with fixed price options enjoy[ing] a huge windfall from the long-running bull market that was fueled not only by corporate performance but also by factors beyond management control, such as declining inflation and lower interest rates": A. Rappaport, "New Thinking on How to Link Executive Pay with Performance" March/April Harvard Business Review (1999) 91, 92. See also Conyon and Murphy who

based pay increasingly forms a significant part of pay structures in the UK, reliance on high-powered equity-based contracts is more limited in continental Europe. These results may also be explained by a further dimension to the blockholder/dispersed ownership distinction: equity-based remuneration is less likely to be attractive to executives where a publicly traded, but closely held, company has only a small "free float." In such circumstances, the problemmatic link between managerial performance and share price (see below) becomes even more opaque and there is a greater possibility of the share price being influenced by noise.[28] While an increasing number of continental companies are being publicly traded, core concentrated ownership is not being fully dismantled: in many European countries public offerings are limited to the minimum necessary for listing purposes.[29]

Advantages

Options can create potentially powerful incentives which align otherwise diverging shareholder and executive interests by linking pay to shareholder returns expressed via the share price. They can incentivize managers to take efficient decisions, which may be personally stressful, such as decisions to lay-off staff and close businesses, and may exert a bonding function among senior management and promote greater efforts to increase the global value of the company and the share price.[30] They have, on first glance at least, an attractively asymmetrical pay structure in that they reward success but do not appear to penalize failure: managers are not likely to equate the failure to make a gain with an actual loss. Options can also act as a powerful inducement to join a company and, where the plan is structured over an appropriate length of time, incentivize management to stay. By contrast, fixed salaries are set in advance and thus have limited incentive effects. Cash payment are also highly visible and transparent and may therefore generate backlash effects which prevent them from acting as effective incentive alignment devices

Disadvantages

There are a number of difficulties with share options, however, which might support regulatory intervention, particularly with respect to governance structures: they may give management, when it can influence the pay-setting process, scope to skim wealth from shareholders and to disguise the skimming through the structure of option pay. At the core of the problem is the extent to which share options are, in practice, performance-based and align incentives. There are ways of structuring option grants to avoid or minimize the problems which they seem to generate. This suggests that the share option problem may be a governance problem rather than a difficulty with the option as a tool of executive pay per *se.* This analysis appears to drive the European responses to remuneration, which focus on governance, disclosure, and core conflict of interest management, rather than on direct intervention in pay structures.

The inherent inefficiencies generated by share options include: the relative performance problem; dilution; repricing; and their impact on dividends and management risk management. A particularly acute problem concerns relative performance. Fixed price options can deliver very large gains for executives whenever the market is rising, even if the

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have referred to the 300% increase in the S&P Index in the 1990s, as compared to the 150% increase in the FTSE, as a partial explanation for the large gulf between US and UK CEO packages: note 22, F666.

[28] Cheffins note 24, 12.

[29] Becht and Mayer (2001) note 20, 8.

[30] See, eg, Gordon note 19, 14-15.

company is underperforming its competitors. One way of preventing executives from generating massive gains from market performance is to link the option's exercise price to a market or peer group index such that managers are rewarded only when they outperform the competition. Share options are, however, rarely indexed to the market in the remuneration market which is generating most controversy, the US.[31] Accounting rules may account for this anomaly in that options which carry performance conditions must be accounted for as an expense rather than being covered by footnote disclosure. While the US experience shows the potential options have for management wealth extraction, benchmarked options and options linked to performance targets are popular in the UK.[32]

The capacity for share options to be repriced also weakens the incentive justification and suggests that, where management gains control of the pay-setting process, it has scope to extract wealth. The US evidence suggests that repricing does not respond to industry shocks, which would justify repricing in order to preserve incentives, but typically arises on poor firm performance.[33] The hidden costs of share options also include their impact on dividend policy. If share options appropriately align shareholder and management incentives, one consequence should be that management is incentivized to allocate cash flow in order to maximize shareholder value. Share options can distort this alignment in that they can incentivize management to reduce dividends, as the value of options drops with dividend payments.[34] There is some empirical evidence to suggest that executive share options can reduce dividend distributions to shareholders.[35] While reductions in dividends can be offset by repurchases, and it appears that executive share options can result in a shift away from dividends and towards repurchases,[36] share options nonetheless impact on how management sets dividend policy. Thus, another forum for conflicts between management and shareholders appears to emerge. Share options also carry the risk of dilution. There are a number of costs associated with dilution, including a reduction in EPS and entrenchment of management voting power. There is some US evidence that the large numbers of shares subject to option plans is generating shareholder unhappiness as to the consequent dilution:[37] for example, US institutional investors recently revealed unhappiness with the potential dilution represented by share option programmes at the 2003 BAE Systems AGM.[38] Another difficulty cited with share options as evidence of their failure to align interests is that the proportion of pay which is fixed or cash-based does not seem to drop as share option, or performance-based, pay is increased.[39] The absence of such rebalancing might suggest that

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[31] M. Bertrand and S. Mullainathan, "Do CEOs Set Their Own Pay? The Ones Without Principals Do" NBER Working Paper 7604 (2000) 9.

[32] See, eg, Lex (2002) note 16 (noting that performance criteria have allowed UK companies to fend off the criticism of share option pay faced by US companies).

[33] M. Brenner, R. Sundaram and D. Yermack, "Altering the terms of executive stock options" 57 J. Fin. Econ. (2000) 108 and D. Chance, R. Kumar, and R. Todd, "The "repricing" of executive stock options" 57 J. Fin. Econ. (2000) 129, 153.

[34] M. Arnold and R. Gillenkirch, " Stock Options as Incentive Contracts and Dividend Policy" SSRN (2002), 1.

[35] For US evidence see R. Lambert, W. Lanen, and D. Larcker, "Executive Stock Options Plans and Corporate Dividend Policy", 24 J. of Financial and Quantitative Analysis (1989) 409 and S. Weisbenner, "Corporate Share Repurchases in the 1990: What Role Do Stock Options Play" SSRN (2000) 1, 3.

[36] For US evidence see G. Fenn and N. Liang, "Corporate Payout Policy and Managerial Stock Incentives" 60 J. Fin. Econ. 45 (2001) 46.

[37] See, eg, A. Morgan and A. Poulsen, "Linking Pay to Performance - Compensation Proposals in the S&P 500" 62 J. Fin. Econ. (2001) 489. See also K. Chauvin and C. Shenoy, "Stock Price Decreases Prior to Executive Stock Option Grants" 7 J. Corp. Fin. (2001) 53 who have noted that the announcement of a share option plan might be considered bad news because of the dilution which will occur on exercise of the options (at 62).

[38] See, eg, S. Mesure, "BAE confirms Boeing talks as US investors stage protest over pay", *The Independent* April 20 2003.

[39] See, e.g, in the UK context, Main (1999) note 21, 95.

share option pay is vulnerable to management influence. Finally, share options may incentivize management to pursue projects which increase the volatility of the company's value.[40] The pendulum may, however, swing too far. Executives holding very large share option grants may be perversely incentivized to engage in very risky or fraudulent activity to maintain a high share price over a short time frame.[41]

The structure of share option pay represents a minefield into which the legislator should step warily, if at all. They display many structural defects which may damage the incentive alignment or performance link and their complexity, combined with their potential invisibility as an accounting expense, may make it easy for vast wealth transfers to be hidden from shareholders. But design problems are largely in the hands of the board and its allied structures. If the board is acting for shareholders and bargaining in an adversarial manner, design and structure problems can be mitigated. Defects in this process can, however, result in a manipulation of that process. While the connection between bad governance and suboptimal pay structures is not entirely clear,[42] it does appear that good governance is central to the adoption of optimal share options. The European response to pay certainly suggests that, even in those systems where the focus on pay as a device to monitor management is reduced, governance controls are becoming increasingly important, in some legal systems, at least as a protection for minority shareholders.

1.3.3 Governance and The Pay Setting Process

Adoption of an optimal contract is therefore dependent on the pay-setting process taking place in an adversarial manner between self-interested parties seeking to maximize their interests. If this happens, it becomes difficult to find the market failure justifying controls on the pay process. In dispersed ownership systems, in practice, pay is not set at arms' length, as the board, composed of or aligned to senior management and not a perfect agent for shareholders, negotiates on both sides of the pay bargain in an inherently conflicted situation in which it is incentivized not to maximize the shareholders' interests. In listed continental companies, however, the Anglo-American focus on the effectiveness of governance mechanisms allied to the incentive contract, such as independent directors, shifts towards the effectiveness of monitoring via large blockholders, financial institutions which provide debt financing, and long-standing, interlocking relationships between management, shareholders, financiers, and other stakeholders. Concentrated ownership should also, as long as the CEO and senior management do not form part of the controlling group, limit the possibility for pay-setting to be transformed into a process of skimming or rent extraction.[43] The supervisory board which features in a number of continental governance systems also provides an important management-control mechanism and, in particular, provides financial institutions with a forum for monitoring management. Labour co-determination is also likely to keep pay at politically acceptable levels.

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[40] See S. Rajgopal and T. Shevlin, "Empirical Evidence on the Relation Between Stock Option Compensation and Risk Taking" 33 Journal of Accounting and Economics (2002) who have found, in the US oil and gas industry, that share options appear to motivate managers to take on exploration risk.
[41] For this analysis in the context of the Enron collapse see Gordon (2002) note 19, 16.
[42] See, eg, Brenner *et al* (2000) note 33 who point (in the US) to an 80% higher frequency in repricing where there is disclosure of a conflict of interest in the compensation committee, and to the greater incidence of repricing in small firms which tend to be monitored less closely by the financial press and to have less institutional investor ownership (at 123-127).
[43] Bebchuk *et al* note 4.

In the dispersed ownership context, however, an incentive contract which emerges via a flawed process in which the board has lost control of the pay-setting process to management might be better regarded as an expression of wealth-skimming (or rent extraction) by self-interested executives, rather than of arms-length contracting.[44] If this is the case, governance controls "matter" in that they can increase the possibility of the pay-setting process being a contracting one, in which shareholder interests are maximized, rather than a skimming one, in which the board is captured by management. A key question then arises: what is good governance in the pay context? Arguably, it ensures that shareholders stay in control of the process, whether through disclosure, the presence of institutional investors and independent directors, or the use of remuneration committees, such that the pay-setting body ensures that the contract is optimal from shareholders' perspective. The discussion below highlights some of the potential weaknesses in governance with respect to pay.

(a) The Board of Directors and Independent Directors

The adversarial process is weakened in the first instance where the board is passive or captured by management, poorly incentivized to bargain for optimal pay, and not an effective agent for the shareholders. There are a number of reasons for this including: conflicts of interest where directors form the senior management group; board dynamics which often result in deference and politeness towards the CEO; social ties; and the influence of the CEO over the appointment of directors. The addition of independent directors to the board (or remuneration committee) may provide a solution and is a dominant theme of European responses to remuneration, albeit adjusted, in blockholding systems, to reflect the weaker priority attached to remuneration contracts, the influence of controlling shareholders, and (where relevant) two tier board structures. Independent directors should be able to withstand any overbearing influence of senior management and be more likely to judge performance objectively and with respect to the company's performance. There are, however, a number of countering arguments. These include that: independent directors may be reluctant to disturb the status quo being friends of/appointed by the CEO, or incentivized to set pay in a manner beneficial to them where they are serving executive directors; they may lack expertise on pay or have insufficient time to become expert; disclosure flows to independent directors on performance may be unreliable; and reputational factors, which may result in an independent director who is regarded as "tough on pay" being blacklisted from other boards may arise. The empirical evidence on the effectiveness of independent directors is also equivocal: it has been suggested that independent directors have not controlled executive pay but rather presided over its explosion.[45] A particular difficulty here concerns the trade off between independence and incentives. Independent directors in the dispersed ownership context typically own only small amounts of company shares and so have limited incentives to monitor carefully. One way out of this impasse is further disclosure of the extent of the ties between independent directors and the board of directors/CEO. Another is to readjust the process by making directors bigger shareholders, thereby readjusting their incentives.[46] The danger of entrenching directors and a loss of their independence due to their financial interest in the company however arises.[47] Yet another is to impose rigorous controls on the

[44] *Ibid.*
[45] S. Bhagat and B. Black, "The Uncertain Relationship between Board Composition and Firm Performance" SSRN (1999) 4 have noted that CEO pay in the US exploded over the period when independent directors became dominant on the boards of large firms.
[46] See generally Elson note 12.
[47] Gordon note 19, 12 has noted that while share-based pay may enhance the director/shareholder alignment, it is also likely to increase the board's reluctance to engage in actions which might depress the share price.

independence of nominally independent directors which, of course, can only be achieved to a limited degree in blockholding systems (although the need for sharp monitoring by independent directors is also weaker). Finally, composed primarily of management-independent, non-executive directors, and exercising pay-setting functions delegated from the board, the remuneration committee can act as an objective control on the pay-setting process. The influence of management and the CEO may, however, damage its effectiveness. While the evidence is equivocal, some studies suggest that there is little evidence that independent remuneration committees do a better job than inside directors.[48] The capture problem extends beyond the remuneration committee and independent directors. While remuneration consultants provide expertise in the complex area of pay design, and improve the disclosure flow to the remuneration committee on pay practices, they are vulnerable to capture by the board. In such circumstances, the consultant may exacerbate problems by acting as a camouflage mechanism to legitimize sub-optimal pay decisions.[49]

(b) Shareholders and Institutional Investors

Shareholder monitoring lies at the core of the governance issues which surround executive pay in the context of dispersed ownership. As effective monitors, whether via direct shareholder voice mechanisms such as votes on pay or via indirect lobbying, shareholders suffer from the collective action problem and from lack of information. Collective action problems are exacerbated in the case of executive pay as shareholders are unlikely to see great individual gains from a reduction to the costs of pay, and may suffer if management incentives are damaged. In addition, an examination of the optimality of pay decisions requires careful case-by case analysis of disclosure which, even where it is made available, can be difficult for shareholders.

Institutional investors are often regarded as potentially strong corporate monitors. The extent to which institutional investors can bear on the pay process is, however, doubtful. The collective action problem arises and is aggravated by the need for institutions to have holdings across different companies. Institutions may not communicate effectively as a group and so fail to influence management. Agency problems can arise within an institutional investor as those exercising votes need to be incentivized to take action. There is some US evidence, however, that large shareholders (5% and over) can act as an effective governance mechanism with respect to remuneration.[50] UK institutional investors seem increasingly ready to intervene on a company-specific basis and to challenge remuneration packages. Law, and particularly mandatory disclosure, appears to matter in this context. The changes to UK company law in 2002 appear to be galvanizing institutional investors into action. It remains to be seen, however, whether the 2003 AGM season represents a profound change in institutional investor behaviour and reveals a new and effective way of managing pay problems via direct shareholder vote mechanisms, particularly with respect to rewards for failure. It may be that executive pay is an inherently difficult problem for shareholders to manage directly on a sustained basis. Activist shareholder monitoring traditionally concerns

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[48] An earlier survey of UK listed companies found that companies with a remuneration committee paid more, and were not more sensitive to performance, than companies without such committees: B. Main and J. Johnston, "Remuneration Committees and Corporate Governance", 23 Accounting and Business Research (1993) 351. By contrast, see D. Yermack, "Good Timing: CEO Stock Option Awards and Company News Announcements" 52 J. Fin. (1997) 449 which reported (in the US) that the independence of the remuneration committee reduces the tendency of companies to increase executive wealth by awarding share options shortly before the company share price increases.

[49] Bebchuck *et al* note 4.

[50] M. Bertrand and S. Mullainathan, "Agents With and Without Principals" Amer. Econ. Rev. (2000) 203, 204.

process issues which are common to many companies. As executive pay demands firm-specific knowledge it may be inherently less amenable to effective direct shareholding monitoring. In particular, the range of finely calibrated factors which determine whether an option grant is optimal might suggest that shareholders will rarely be in a position to monitor option grants effectively. The difficulties faced by institutional investors in monitoring the incentive contract are, of course, a particular feature of dispersed ownership corporate governance. In concentrated ownership systems the existence of strong blockholders lessens the need for monitoring by an incentive contract, although minority shareholders require protection where controlling shareholders and management collude.

1.3.4 Disclosure

Finally, the complexities of the executive pay problem are equally apparent in the disclosure sphere. The discussion fractures across two faultlines: (i) whether disclosure can act as an effective remedy to, or whether it aggravates, the perceived structure and process problems of executive pay and (ii) whether executive pay structures generate an additional agency cost by distorting the channeling of disclosure to shareholders and the marketplace.

Disclosure can be used to address the procedural and structural problems raised by executive pay. It may, for example, sharpen shareholder monitoring (as appears to be occurring in the UK, although with the caveat that the new disclosure rules are coupled with new voting powers). If full information is provided on pay packages and their relationship to performance, as well as on pay policies and procedures, shareholders can assess whether the board is negotiating effectively and take appropriate action, whether it be in the form of dismissing directors, or the adoption of resolutions. As setting executive pay is a highly complex process, opaque disclosure will not generate effective shareholder activism or oversight. In particular, aggregate disclosure concerning total firm executive pay which does not explain remuneration policy and the often highly complex performance conditions applicable or set out the specific components of the pay packages of particular and named senior executives will not allow shareholders to assess pay policy effectively. Enhanced disclosure may, however, induce institutional shareholders who have greater incentives to monitor management to play a more activist role, in their own self-interest. Disclosure of pay lowers the cost of monitoring by raising the reputation of institutional investor monitors by signaling or publicizing, in effect, the results of their activism and generating greater deterrence effects. It also makes it easier for institutional investors to communicate with one another and with management. Disclosure also impacts directly on the board itself, which is induced to justify pay choices publicly and with more care. By highlighting the role of remuneration committees, disclosure can also ensure its visibility and enhance its accountability.

Disclosure is traditionally associated with minimal regulatory intervention. There are, nonetheless, costs involved in using disclosure to address pay problems. In particular, the benefits of potentially greater shareholder activism must be weighed against popular and political reaction to enhanced disclosure of executive pay. With enhanced disclosure, pay questions are played out in the media, influenced by labour, captured by private interests (such as those of political activists and union personnel), and politically-infused. Remuneration committees may be vulnerable to responding to political and workforce pressures and adopting suboptimal remuneration structures which are not sufficiently sensitive to performance.[51] If the function of disclosure is to ensure that incentives remain aligned, it must be carefully calibrated to send the correct signal. Disclosure which focuses on headline pay levels, invites popular hostility, and does not facilitate shareholders in assessing remuneration structures and the pay-setting process is destabilizing.[52] By contrast, disclosure which makes is easier to assess the pay performance relation/incentive structure and the effective of governance can remedy some of the structural and process weaknesses of executive remuneration. Other costs of disclosure include the danger that disclosure may result in an increase in pay due to a ratcheting effect. Pay surveys may become distorted by very high individual awards and, as they are relied on by remuneration consultants, feed into executive pay generally.[53] Disclosure rules can also have an adverse effect on remuneration by biasing remuneration awards towards particular forms which would not be adopted in an optimal contract. The best known example of this concerns the impact of US accounting rules on the expensing of options. Current accounting rules mean that options are not expensed as a cost against profits as long as they are granted with a pre-determined exercise price and expiry date, and that the exercise price exceeds the fair market value of the relevant shares on the grant date. Options can therefore be used to hide large pay awards and the board is disincentivized to use more performance-sensitive option devices, such as premium options, given the prejudicial impact of such devices on profits. Finally, performance-based remuneration can generate new agency costs by mis-aligning the interests of shareholders in accurate and timely disclosure and management's interest in maximizing remuneration.[54] A manipulation of disclosure can arise following this misalignment. Where remuneration is share-option-based, management is incentivized, and has the opportunity, to manipulate the market price of shares downwards around the dates of share option grants, as the exercise price of an option is usually the share price on the date of the grant. This manipulation can be achieved by the disclosure, shortly before the grant, of news which depresses the share price and, as a result, the option's exercise price or, conversely, the withholding of good news, spinning news in a negative manner, or failing to confirm good news.[55] Management is also incentivized to disclose news which raises the share price shortly before the option's exercise date in order to maximize the profit made on exercise of the option. There is some evidence to suggest that manipulation of this kind occurs.[56] Finally, notwithstanding its appeal as a non-aggressive form of intervention in bridging the difficult governance divide between governance systems and approaches to remuneration across Europe, and its attractions as a bulwark against common European conflict of interest problems and future problems with remuneration if pay practices converge further, disclosure reveals deep cultural divides as to the primacy of privacy as to pay across Europe.

[51] R. Romano, "Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance" 18 Yale Journal of Regulation (2001) 174, 203-204

[52] Murphy note 25.

[53] One pay expert has recently noted, in the context of the 2002 UK pay round, that pay is ratcheted up by companies wishing to pay executives in the upper quartile level of their peers: "Each time a company raises its pay for its executives, this leads to a review at another company": T. Tassell, "Corporate Restraints failing as board pay jumps 23%", *Financial Times* May 7 2003.

[54] C. Yablon and J. Hill, "Timing Corporate Disclosures to Maximise Performance-based Remuneration: A Case of Misaligned Incentives" 35 Wake Forest LR. (2000) 83.

[55] See K. Chauvin and C. Shenoy, "Stock Price Decreases Prior to Executive Stock Option Grants" 7 J. Corp. Fin. (2001) 53, 59-60 on the various ways executives can manipulate information.

[56] See, e.g., Chauvin and Shenoy (2001) *ibid*. Similar results are found in D. Aboody and R. Kasznik, "CEO Stock Option Awards and Corporate Voluntary Disclosures" 29 Journal of Accounting and Economics (2000) 1.

1.4 Conclusion

The sharp differences in their degree of reliance on high-powered incentives, particularly share options, between UK, US, and continental companies seem to bear out the link between pay and corporate governance systems. This link is expanded on in Part B with respect to the different rules found across European legal systems and how they address/prioritize the concerns which executive pay potentially raises. The executive pay problem may therefore be a particular cost of dispersed ownership, and the particular legal and policy responses which are widely debated a specific feature of Anglo-American corporate governance. The picture may be changing. A number of factors may provoke greater convergence in corporate governance and, where dispersed ownership asserts itself, in remuneration practices along Anglo-American lines. These include: the growing equity culture and focus on shareholder value encouraged by the securities market reforms contained in the EC's FSAP; activism by Anglo-American institutional investors and by a new generation of EC institutional investors in the form of collective investment schemes; international competition in the market for executives; evidence of some movement towards more widely held companies and a (limited) loosening of control by family and government blockholders in continental companies.[57] Nonetheless, the faultline between both systems, which is evident from the different approaches European states have taken to remuneration discussed in Part B, calls for particular care in the adoption of pan-European reforms but also in the transplanting of reforms based on the Anglo-American experience.

B A COMPARATIVE OVERVIEW

1. Introduction

The regulatory strategies adopted by the EU Member States to regulate executive remuneration focus on company disclosure and corporate governance structures and procedures. The purpose of Part B is to analyse these strategies with reference to both public regulation and corporate governance best practices, as described in national reports and private codes. Sections 2 and 3 concentrate on annual disclosure and prospectuses and ask, first of all, whether a report or similar information should be published on remuneration policy. Furthermore, they analyse whether the disclosure as to executive pay must be detailed and individualized or general and aggregated. A distinction is made between two groups of countries, depending on the approach followed by the relevant national rules or practices. Sections 4 and 5 analyse the rules on *ad hoc* disclosure with reference to share transactions executed by the company’s insiders and to stock options, their vesting, exercise, and the sale of the relevant shares to third parties. Sections 6 and 7 examine the role of corporate governance structures in executive pay and focus on remuneration committees and the shareholders’ powers concerning remuneration policy. Section 8 concludes.

2. Annual Disclosure and Prospectuses (1): Detailed Information

2.1 General

[57] G. Hertig, "Western Europe's Corporate Governance Dilemma" in T. Baums, K. Hopt and N. Horn (eds.), *Corporations, Capital Markets and Business in the Law* (Kluwer, 2000) 265, 267.

The role of disclosure as a remedy for agency costs has already been analysed in Part A, para. 1.3.4 above. Firstly, disclosure may sharpen shareholder monitoring. Detailed information on remuneration packages, policies and procedures allows shareholders (particularly institutional investors) to review the board's action in this area and react to abuses. At the same time, exposure to public scrutiny induces the board of directors to greater care in setting executive remuneration. This section's analysis will focus on annual disclosure and prospectuses. All the countries considered accept a principle of maximum transparency as to directors' disclosure. However, they implement it in varying degrees of intensity, which may also depend on the different ownership structures of listed companies and the ways in which the agency costs problem is perceived in each jurisdiction.

2.2 United Kingdom and Ireland

(a) Annual Disclosure

These two countries are no doubt the more advanced as to remuneration disclosure. In the UK, as a result of the 2002 revisions to the Companies Act 1985 (set out in the Directors' Remuneration Report Regulation 2002), directors are now required to prepare a Directors' Remuneration Report for each financial year, which contains the information specified in the new Schedule 7A to the Companies Act 1985 (Companies Act s234B(1)). The Report must be approved by the Board of Directors and signed on behalf of the Board by a director or the secretary of the company (s234C(1)). The company's auditors must include in their report on the annual accounts a report on the auditable part of the Directors' Remuneration Report and state whether, in their opinion, that part of the Report has been properly prepared in accordance with the Companies Act (s235(4)).

The Directors' Remuneration Report must be published on a yearly basis (Companies Act s234B(1)) and laid before the general meeting of shareholders for approval (s241 and s241A). Like the annual accounts, the directors' report, and the auditor's report on the accounts, the Report must be sent to every member of the company, every holder of the company's debentures, and every person who is entitled to receive notice of general meetings, within 21 days of the general meeting before which these documents are laid (s238). A copy of the Directors' Remuneration Report, together with the annual accounts, the directors' report and the auditors' report must be filed with the Registrar of Companies before the end of the period for "laying and delivering" accounts, which for public companies is 7 months after the relevant accounting reference period (Companies Act s242 and s244)[58].

The Remuneration Report should include the following information (Companies Act 1985, Sch 7A, Part 3, s2-5):

(i) *Remuneration Committee*. Where a committee of the directors has considered directors' remuneration for the relevant financial year, the Directors' Remuneration Report must name each director who was a member of the committee at any time when the committee was considering remuneration (s2(1)(a)). The Report must also name any person who provided

[58] With respect to distribution, instead of sending the accounts, directors' report, and Directors' Remuneration Report to the entitled persons listed in Companies Act s238, listed companies are permitted to send such persons a summary financial statement of the relevant documents (s251). The summary financial statement must contain the following information with respect to the Directors' Remuneration Report: the statement of the company's policy on remuneration; and the Performance Graph (see below).

the committee with advice or services that materially assisted the committee and state the nature of any other services that person provided the company with during the relevant financial year and whether that person was appointed by the committee (s2(1)(b) and (c)).

(ii) *Remuneration Policy*. The Directors' Remuneration Report must include a statement of the company's remuneration policy for the following financial year and for subsequent financial years (s3(1)). The statement must include, for each director, a detailed summary of any performance conditions to which any entitlement to share options or under a long term incentive scheme is subject, an explanation of why such performance conditions were chosen, and a summary of the methods used in assessing whether the conditions are met (s3(2)). The policy statement must also, in respect of each director's remuneration terms and conditions, explain the relative importance of those elements which are, and are not, related to performance (s3(3)). Finally, the statement must summarise and explain the company's policy on the duration of contracts with directors and on notice periods and termination payments under such contracts.

The Directors' Remuneration Report must also contain a performance graph[59] which sets out the total shareholder return[60] of the company on the class of equity capital, if any, which caused the company to be defined as listed (s4(1)). In addition, the following information must be provided under s5 in respect of the contract of service or contract for services of each person who served as a director at any time during the relevant financial year: the date of the contract, the unexpired term, details of any notice periods; any provision for compensation payable upon early termination; details of other provisions in the contract as are necessary to enable members of the company to estimate the liability of the company in the event of early termination.

(iii) *Detailed Audited Financial Information*. This information should include, for each person who has served as a director at any time during the relevant financial year :

[59] Under s4(1)(a) and (b), s4(2), and s4(3), a line graph must show for (i) a holding of shares of that class of the company's equity share capital whose listing or admission to dealing has resulted in the company being listed for the purpose of the application of the remuneration report requirement and (ii) a hypothetical holding of shares, made of shares of the same kinds and number as those by reference to which a broad equity market index is calculated, a line drawn by joining up points plotted to represent for each of the financial years over a five year period, of which the last is the relevant financial year (to which the Report relates), the total shareholder return on that holding. It must also state the name of the index used and the reasons for choosing it. Where the company has been reporting for less than five years, the period is 2, 3, or 4 years, as the case may be. In its first financial year, the period is the relevant financial year.

[60] Total shareholder return is calculated (s4(4)) using a "fair method" which: takes as its starting point the percentage change over the period in the market price of the holding; makes specified assumptions as to reinvestment of income and funding of liabilities (see s4(5) and 4(7)); and makes provision for any replacement of shares in the holding by shares of a different description. The same method must be used for each of the holdings.

The assumptions as to reinvestment of income (s4(5)) are, first, that any benefit in the form of shares of the same kind as those in the holding is added to the holding at the time the benefit becomes receivable and, second, that any benefit in cash (such as dividends), and an equivalent amount of any non-cash benefit (excluding shares) is applied, at the time the benefit becomes receivable, in the purchase, at their market price, of shares of the same kind as those in the holding, and that the shares purchased are added to the holding at that time.

The assumption as to funding of liabilities (defined as a liability in respect of any shares in the holding or arising from the exercise of a right attached to any of those shares) is that, where the holder has a liability to the company of whose capital the shares in the holding form a part, shares are sold from the holding: immediately before the time by which the liability is due to be satisfied; and in such numbers that, at the time of the sale, the market price of the shares sold equals the amount of the liability in respect of the shares in the holding that are not being sold (s4(7) and (8)).

- emoluments (Companies Act 1985, Sch 7A, Part 3, s6(1)-(4))[61];
- share options (s7-9): detailed information is required[62]. This information must, however, be aggregated and simplified where the directors are of the opinion that full disclosure would result in "excessively lengthy" reports (s7(2) and s9(1));
- long term incentive plans, excluding any information already provided under the share option rules (s10-11);
- pensions (s12);
- sums paid to third parties in respect of directors' duties (s15).

By contrast with the UK regime, a specific remuneration report is not required under Irish company law, although the Listing Rules do require that the Board reports, in the annual report and accounts, to shareholders on remuneration. Under Listing Rule 12.43(c), the annual reports and accounts must contain a report to the shareholders by the board on directors' remuneration. This must contain:
- a statement of the company's policy on executive directors' remuneration;
- for each director by name and for the period under review, the amount of each element in the remuneration package for the period under review;
- in tabular form and for each director by name, information on share options;
- details of any long term incentive schemes, other than share option schemes previously disclosed;
- explanation and justification of any element of salary, other than basic salary, which is pensionable;
- a statement of the company's policy on the granting of options or awards under employee share schemes and other long term incentive schemes;
- detailed disclosure on defined benefit pensions schemes, particularly with respect to transfer value.

(b) Prospectuses

With respect to listed companies, the disclosure required in the public offer prospectus, both in the UK and Ireland, tracks that required by the listing particulars (subject to the adaptations appropriate to the circumstances of a public offer). The prospectus and the listing particulars must include the total aggregate of the remuneration paid and benefits in kind granted to the

[61] In tabular form in respect of each director: total amount of salary and fees (s6(1)(a)); total amount of bonuses (s6(1)(b)); total amount of expenses chargeable to UK tax (s6(1)(c)); total amount of compensation for loss of office and other payments in connection with termination of qualifying services (s6(1)(d)); total estimated value of non-cash benefits not covered elsewhere (s6(1)(e)); total amount of (a)-(e). In addition, the total amount from (a)-(e) must be shown for each director for the previous financial year (s6(2)). The Report must also specify the nature of any non-cash elements of the remuneration package (s6(3)).

[62] In tabular form in respect of each director: (a) the number of shares subject to a share option at the beginning of the relevant financial year (or, if later, on the date of the director's appointment as a director) and at the end of the relevant financial year. A distinction should be made between share options with different terms and conditions (s8(a)); (b) information identifying: those share options awarded in the relevant financial year; those exercised in that year; those that have expired unexercised; and those whose terms and conditions have been varied in that year (s8(b)); (c) for each unexpired share option: the price paid, if any, for its award; the exercise price; the exercise date; and the expiry date (s8(c)); (d) a description of any variation made in the relevant year to the terms and conditions of a share option (s8(d)); (e) a summary of any performance criteria upon which the award of an option is conditional, including a description of any variations made to these criteria during the relevant financial year (s8(e)); (f) for each option exercised during the relevant financial year, the market price of the shares in relation to which it is exercised at the time of exercise (s8(f)); and (g) for each unexpired option at the end of the relevant financial year: the market price at the end of the year; and the highest and lowest market price during that year of each share subject to the option (s8(g)).

directors by any member of the group during the last completed financial year under any description whatsoever. In the case of an issuer which is a company subject to the Companies Act 1985, interests (distinguishing between beneficial and non-beneficial interests) should be disclosed relating to securities which: (a) have been notified by each director to the issuer pursuant to section 324 or section 328 of the Companies Act 198see para. 4.2 below; (b) are required pursuant to section 325 of that Act to be entered in the register referred to therein See para. 4.2 below ; or (c) are interests of a connected person of a director which would, if the connected person were a director, be required to be disclosed under (a) or (b) above, and the existence of which is known to or could with reasonable diligence be ascertained by that director see para. 4.2 below. In addition, the following information should be disclosed:

- the total of any outstanding loans granted by any member of the group to the directors and also of any guarantees provided by any member of the group for their benefit;
- details of any schemes for involving the staff in the capital of any member of the group;
- particulars of any arrangement under which a director of the issuer has waived or agreed to waive future emoluments together with particulars of waivers of such emoluments which occurred during the past financial year;
- an estimate of the amounts payable to directors of the issuer, including proposed directors, by any member of the group for the current financial year under the arrangements in force at the date of the listing particulars;
- details of existing or proposed directors' service contracts including the matters specified in paragraph 16.11 of the Listing Rules (which sets out disclosure requirements for services contracts, including that they be made available for inspection and that they disclose, inter alia, the unexpired term and details of any notice period, together with full particulars of the director's remuneration and any details necessary to enable investors to estimate the possible liability of the company on early termination), or an appropriate negative statement;
- a summary of the provisions of the memorandum and articles of association of the issuer with regard to any power enabling a director to vote on a proposal, arrangement, or contract in which he is materially interested; any power enabling the directors, in the absence of an independent quorum, to vote remuneration (including pension or other benefits) to themselves or any members of their body; borrowing powers exercisable by the directors and how such borrowing powers can be varied; and retirement or non-retirement of directors under an age limit.

2.3 France and Italy

(a) Annual Disclosure

Under French law, the directors' annual report must indicate the total amount of compensation and benefits awarded to each corporate officer (*Code de Commerce*, Art. L225-102-1, also applicable to non-listed companies). Moreover, according to best practice, the annual reports of listed companies should include a chapter, drafted with the compensation committee's assistance, on corporate officers' compensation (see *Viénot 2nd Report* p. 23, and *Bouton Report* p. 13). In addition, the board of directors must submit to the shareholders' AGM a special report concerning stock options and stock grants to directors. The report indicates the number of options or shares which executive directors are allowed either to exercise or purchase during the year, their expiration date and exercise price. The same information is given for options and shares bought or subscribed by directors during the year (*Code de Commerce*, Art. L225-184 also applicable to non-listed companies). The same rules apply to the ten top employees.

A remuneration report is also not required in Italy. However, the Italian Exchange recommends including in the Corporate Governance report summary information on the remuneration system adopted, specifying whether the remuneration paid to executive directors and senior managers is linked to the company's results or the achievement of specific objectives. Similar information should also be provided on stock option plans, if any. In addition, listed companies must indicate in the notes to the accounts the remuneration paid to each director, member of the board of auditors and general manager (Consob Regulation 11971/1999 art. 78). Such information is to be presented in tabular form and include: fees, including those fixed by the shareholders' ordinary meeting, contingent profit sharing, attendance money, and flat expenses refunds; non-monetary benefits, including fringe benefits and insurance policies; bonuses and other rewards (not including stock options); other fees, including those received from subsidiaries, salaries, and retirement bonuses (Consob Regulation 11971/1999 Annex 3C Scheme 1).

Companies must indicate in the notes to the accounts details about stock options and stock grants of each director and general manager by name (Consob Regulation 11971/1999 art. 78). Such information is to be presented in tabular form and contain: options held at the beginning of the period under review; options granted during the period under review; options exercised during the period under review, together with the spot price at the moment of the exercise; options expired in the period under review; options held at the end of the period under review. A description is required of the major elements of the stock option plans in order to provide full disclosure of the principles and aims which characterise the plans. Stock grants are to be accounted for as options vested and immediately exercised with a strike price equal to zero (Consob Regulation 11971/1999 Annex 3C Scheme 2). Consob recommends that companies indicate in the management report information concerning the adopted stock option plans, including, but not restricted to: the reasons for the plan, a short description of the plan, the amount of shares involved, the offerees, the terms and the conditions of grant and exercise; and, if the plan is particularly important, its duration, together with an indication of the options held and vested at the end and beginning of the period under review, options granted, exercised and expired during the period, and strike prices and the spot prices (Consob Communication 11508/2000).

(b) Prospectuses

COB's regulation (*Instruction de décembre 2001*) provides that prospectuses and listing particulars must include:

- the total amount of remuneration paid and benefits in kind granted – directly or indirectly – by the company and by its subsidiaries to each corporate officer (*mandataire social*);
- the number of stock options granted and the number of options exercised by each corporate officer during the previous financial year; the information must include the exercise price, the expiration date and the type of plan;
- the number of stock options granted and the number of options exercised by the ten most highly paid (with regard to these instruments) employees (non corporate officers) during the previous financial year; this information must be given in aggregated form and must include both the average exercise price and the type of plan.

In Italy, the disclosure required in the public offer prospectus tracks that required by the admission to listing prospectus. The prospectus must contain:

- the total amount of remuneration under any kind or any form granted to each member of the board of directors and board of auditors (*collegio sindacale*) and to each general manager during the last financial year, distinguishing the amounts paid by the company from those paid by its subsidiaries;
- the amount and type of financial instruments, including stock options, of the company and its subsidiaries held by each member of the board of directors and board of auditors (*collegio sindacale*) and by each general manager, or by connected persons; any options on the above-mentioned instruments, distinguishing for each person the instruments held at the beginning of the financial year, the instruments purchased and sold during the year, and the instruments held at the end of the year;
- all relevant particulars regarding the nature and extent of any interests of each member of the board of directors and the board of auditors (*collegio sindacale*) and by each general manager of the issuer in transactions which are or were unusual in their nature or conditions or significant to the business of the group, and which were effected by the issuer during the current or immediately preceding financial year, or during an earlier financial year and remain in any respect outstanding or unperformed;
- any interests of the managers of the company in any member of the group;
- the total of any outstanding loans granted by any member of the group to the members of the board of directors and the board of auditors (*collegio sindacale*) and to the general managers and also of any guarantees provided by any member of the group for their benefit (Consob Regulation 11971/1999 art. 4, Annex 1B Schemes 1-2).

2.4 Netherlands and Sweden

(a) Annual Disclosure

Since 1 September 2002 Dutch "open" public companies[63] have to include in the explanatory notes to their annual financial statements the amount of each director's remuneration in the relevant financial year (Art. 283c, Book 2, Civil Code)[64]. The amount of each type of remuneration should be specified, such as periodic remuneration, long-term schemes, termination payments, profit sharing schemes and bonuses[65]. Additional requirements apply where members of either the management board or the supervisory board are granted the right to acquire shares in the company's capital (Art. 283d). In this case, the company must report for each member: the strike price and the price of the company's shares at the time of the grant (if lower than the strike price); the number of unexercised rights at the beginning of the financial year; the number of rights granted in the course of the financial year and the relevant conditions (any change of conditions should also be reported); the number of rights exercised together with the number of shares purchased and the relevant strike price; the

[63] "Open" public companies include all companies of the NV type, with the exclusion of NVs who (1) only have registered shares (no bearer shares) (2) have restrictions on transfer of shares and (3) whose articles do not allow for the issue of depository receipts of shares in bearer form.

[64] This Article also requires a report on each former director's remuneration to the extent paid in the relevant financial year. For former members of the management board, long-term payable remuneration and termination payments should be specified.

[65] If the company paid a bonus (partly) based on the achievement of stated targets, information will be given on whether these targets were achieved in the relevant financial year. If the company made a profit sharing or bonus payment to members of the supervisory board, the reasons for granting this type of remuneration shall be reported separately.

number of unexercised rights at the end of the financial year, the relevant strike price, the time for the exercise of those rights and other data useful for their valuation; the conditions, if any, applicable to the granting and exercise of those rights. Moreover, Art. 391, para. 2, Civil Code, requires the company's annual financial statements to report on remuneration policy with respect to directors and supervisory board members and on how this policy was implemented in the relevant financial year.

In Sweden, listing agreements require disclosure of senior executives' remuneration by incorporation of a recommendation of the Swedish Industry and Commerce Stock Exchange Committee (*Näringslivets Börskommitté - NBK*)[66] to this effect. This recommendation is directed to Swedish and foreign companies whose shares or depository receipts are listed on a Swedish stock exchange or authorized marketplace[67]. The recommendation is incorporated as a binding annex to the listing agreements, so that non-compliance with the same is sanctionable.

Listed companies' annual reports must provide information concerning remuneration and other benefits which senior executives receive from the company[68]. "Senior executives" are: the chairman of the board; other directors who receive remuneration from the company in addition to the customary director's fee and who are not employed by the company; the managing director; the group chief executive (if any) and some salaried executives in the company's senior management team. Information must include remuneration and benefits provided by all group companies, whether Swedish or foreign. The company is to specify the criteria adopted for senior executives' remuneration, with particular regard to fixed and variable remuneration and the proportion of the same. Information shall be provided for each "top manager" [69] regarding: the total amount of remuneration and other benefits; all remuneration items which are not of minor importance; the fixed and variable components of remuneration, including the main criteria applied for the calculation of variable remuneration[70]; financial instruments, options or entitlements received during the year in connection with incentive programmes linked to share prices, and the estimated market value on the date of allotment and the acquisition price[71]; financial instruments, other options or entitlements received during previous years in connection with incentive programmes linked to share prices; agreements concerning future pensions and severance payments.

Information shall also be provided as to the preparatory and decision-making process followed by the company when determining remuneration for top management. Such

[66] Available in English at www.naringslivetsborskommitte.se.

[67] However, foreign companies listed in Sweden can and often get an exemption from these rules.

[68] If the benefits received by senior executives change significantly during the year, this must be made public in the first interim report.

[69] In the NBK's recommendation, the chairman of the board, relevant members of the board, the group chief executive and the managing director are defined as "top management". The expression "other senior executives" refers to persons who are not members of this group. Normally, this applies to persons employed by the company who constitute the group management team or corresponding unit, which also includes the managing director.

[70] In the case of variable remuneration (bonuses, earnings-related payments and similar remuneration), the total amount is to be stated in the form of information regarding the amount charged against the company's profits for the year, and also the main principles for calculating and determining the variable remuneration.

[71] This information must indicate whether or not the allotment involves a benefit (subsidy) for the individual concerned. If there is no established market value for the instrument in question, a theoretical value should be computed, in accordance with a generally recognized valuation model. In this connection, information must be provided concerning the major assumptions that have been applied.

information should include whether or not a compensation committee has been appointed and, if so, its mandate and composition. Even if a compensation committee has been established, it is required that decisions regarding the managing director and the group chief executive, if any, be taken by the board.

(b) Prospectuses

In the Netherlands, the requirements relating to the content of the prospectus of listed companies or companies requesting a listing (IPO) are laid down in the Euronext rulebook (FR). Article 8 of this rulebook refers to appendix A of the FR which requires that the prospectus shall report: (i) the remuneration and benefits in kind of the full management board and the full supervisory board in the most recent financial year (ii) the total amount of loans made by the company to members of the management and supervisory board and (iii) the total amount of company shares owned by all members of the management and supervisory board together and their option rights granted on the shares of the company. This requirement clearly has not yet been brought in line with the new disclosure requirements of individual directors' remuneration of art. 2:283c BW.

As to Sweden, prospectuses should include the same information for the last financial year as is required by the NBK’s recommendation as to the annual accounts.

3. Annual Disclosure and Prospectuses (2): Summary Information

3.1 General

In several European countries little disclosure is required as to executive remuneration and/or only aggregate data are published as to directors’ pay. This practice is based on a long tradition of opaqueness as to remuneration, generally motivated by confidentiality arguments. The costs of disclosure, highlighted in Part A, para. 1.3.4, may also explain the publication of only summary information on executive pay. Firstly, enhanced disclosure may trigger political reactions and public hostility to the company if the level of pay is perceived as excessive. In addition, labour and the unions may try to interfere with the remuneration setting process. As a consequence, the board may become distracted by these pressures from setting optimal remuneration. Secondly, disclosure may result in an increase in pay due to a ratcheting effect. All this may have determined most of the disclosure rules and practices that are described below, on the increasingly questionable assumption that the benefits of full remuneration transparency would be overwhelmed by its costs. However, recent corporate governance codes adopted in some of the countries considered go in the direction of full disclosure, as shown in the following paragraphs.

3.2 Germany and Austria

(a) Annual Disclosure

In Germany information on directors’ remuneration (management board and supervisory board) is included in the notes to the consolidated financial statements. According to section 285, number 9, Commercial Code, companies must publish the total, aggregate remuneration (salaries, profit sharing, dividend rights, expense allowances, insurance payments, commissions, and fringe benefits of every kind) of the management board membership separately from the aggregate remuneration figure for the supervisory board membership. Pension payments are disclosed separately for all former members of the management and supervisory board.

As to German best practice, the Cromme Code specifies (4.2.4) that the compensation of members of the management board which is reported in the notes be subdivided according to fixed, performance-related, and long-term incentive components and disclosed on an individual basis. The same information should be published in the notes with respect to the compensation of members of the supervisory board. All remuneration should be subdivided according to its components and regard should also be had to payments made by the company or advantages extended for services provided individually. These payments and advantages are to be listed separately (Cromme Code 5.4.5). The Cromme Code also provides (7.1.3) that the consolidated financial statements contain specific information on company stock option programs and similar securities-based incentive schemes. Moreover, the Code provides (4.2.3) that the details of stock option plans or comparable compensation systems are to be disclosed in a suitable form.

The most controversial aspect of the Cromme Commission's conclusions concerns the publication of management board members' individual remuneration in the financial reports. German business circles have traditionally avoided discussing executive remuneration. As a result, even blue chips like Allianz and Daimler-Chrysler do not comply with the relevant provision of the Code and explain that this would either level or prevent differentiated remuneration. Daimler-Chrysler also refers to the principle of collective responsibility (see the Annex for further information on German practice).

Similarly, under Austrian law, the annual report must contain the total remuneration of the management board members (as a group) and of the supervisory board members (section 239 Commercial Code). Remuneration comprises salary, profit participation, reimbursement of expenses, insurance premiums, commissions and additional benefits of any kind. In addition to the statutory requirement to report the total remuneration of the management board, the Corporate Governance Code states that the fixed and performance-linked components of the remuneration are to be disclosed in the annual report (para. 30). Moreover, the Code specifies that the management board's compensation is to be reported on separately for each board member (para. 31).

With respect to stock options, the annual report must indicate for members of the management board and the supervisory board, employees, and senior managers: the number and distribution of options granted and related shares; their essential terms, such as the exercise price or how the same is to be computed, and the respective estimated values at the time they are issued; the transferability of the options; and the periods in which the options can be granted and exercised and the period of lock up. Further information is to be disclosed as to the number, the distribution and the exercise price of the options exercised during the period under review (Corporate Governance Code para. 29; section 239 Commercial Code).

(b) Prospectuses

In Gemany, information on directors' remuneration in public offer prospectuses is subject to section 28 of the Stock Exchange Admission Regulation. The prospectus shall (*inter alia*) contain: the aggregate remuneration (salaries, profit participations, expense allowances, insurance premiums, commissions and fringe benefits of any kind) paid to the members of management and supervisory bodies during the last financial year; such amounts shall be stated separately for each body (section 28 (2) number 2); the total number of the issuer's shares held by members of the management and supervisory bodies in aggregate and any rights to subscribe for shares granted to such persons (section 28 (2) number 4); and the aggregate amount of any loans granted by the issuer to members of the management or supervisory bodies which have not been repaid, and of any guarantees or other warranties given by the issuer for the benefit of such persons (section 28 (2) number 6).

In Austria, according to the Capital Markets Act (Schemes A and B, Chapter 3 n. 17-18) the public offer prospectus shall contain information on the remuneration of the management and the supervisory board. The same information must be provided in the listing particulars (Scheme A, Chapter 6.2a Stock Exchange Act).

3.3 Spain, Belgium and Luxembourg

(a) Annual Disclosure

Section 200.12 of the Spanish Law on *Sociedades Anónimas* (LSA) requires aggregate disclosure of board members' remuneration[72]. The Olivencia Report (1998) recommended the publication of directors' individual remuneration packages and specific disclosure, to the greatest extent possible, of the individual components of remuneration[73]. The recent Aldama Report (2003) noted the slow implementation of this recommendation, reiterating that full disclosure of directors' remuneration is a clear indicator of the quality of corporate governance. The Committee suggested that the annual report specify each director's remuneration, breaking it down into its various components. With respect to executive directors, however, the Report stated that the amount received as a director (to be specified individually in the annual report) could be separated from the amount received as a manager: that amount would be included in the total remuneration of top management and reported as an aggregate amount. This amount would be specific as to cash salary, salary in kind, stock options, bonuses, pension schemes, indemnification provisions, and other compensation.

In Belgium, the Corporate Governance Recommendations issued by Euronext Brussels and the B.F.C. recommend including a corporate governance section in the annual report[74] which should specify the total amount of the executive management's remuneration and the fixed

[72] The following information must be included in the annual reports of listed companies: "The amount of salaries, allowances and emoluments of all kinds earned in the financial year by the members of the Board of Directors, on whatever basis, as well as the obligations entered into in relation to pensions or payment of life insurance premiums for former and present members of the Board of Directors. This information shall be given as an aggregate amount for each type of payment."

[73] The Olivencia Commission recommended that the policy of disclosing director remuneration should be inspired by the principle of maximum transparency which requires full and detailed disclosure of the directors' remuneration, including fixed fees, per diems, profit-sharing, bonuses, incentives, pensions, insurance premiums, payments in kind, etc. The Commission recommended that companies choosing to implement transparency in stages should publicly disclose their reasons in the company's annual report. However, companies should at least disclose each director's remuneration. Executive directors' remuneration could be disclosed as an overall figure, indicating the number of directors collecting them under each of the remuneration headings. All this information should be included in the annual report.

[74] If the annual report constitutes a "reference document" (shelf-registration procedure), it will also contain the information required by the Royal Decree of 18 September 1990 (prospectus).

and variable parts of the same. In addition, the principles, if any, governing the calculation of the variable part should be disclosed (para. 3.1). Under Belgian law, only the total amount of directors' remuneration has to be reported in the notes to the financial statements (Royal Decree of 30 January 2001).

In Luxembourg, listed companies are not required to publish a remuneration report or similar information. The annual accounts specify the board's remuneration as a whole, without providing the details of each director's pay. However, if the board delegates the day to day management of the company to one of its members (which boards generally do), the remuneration paid to this executive director must be disclosed to the annual general meeting.

(b) Prospectuses

In all countries considered in this section, prospectus disclosure is limited to aggregate data on founders', directors' and managers' remuneration. Information on stock-options is also included, but always in aggregate form (see, for Spain, OM of July 12, 1993, Annex A; for Belgium, the Royal Decree of 18 September 1990; for Luxembourg, the Grand-Ducal decree of 28 December 1990, Schedule A).

3.4 Denmark and Finland

(a) Annual Disclosure

Under Danish law, the annual report must contain information on the aggregate remuneration paid to the board of directors in the relevant financial year (Art. 69 of the Annual Accounts Act). The report must also disclose any incentive programs that include members of the board of directors or board of management, with an indication of the categories of members included as well as of the kinds of benefits involved and the information necessary to evaluate the program. In addition, according to the rules issued by the Copenhagen Stock Exchange[75], the annual report must contain information on any parts of the program that have not been exercised by the expiry of the relevant financial year, disclosing the non-exercised parts which relate to members of the board of directors, members of the management board, and other members of senior management, respectively. According to the Nørby Committee's recommendations, the remuneration of each board member and member of management under share-based incentive programs should be disclosed in the annual report.

In Finland, no remuneration report is required. Information on the collective remuneration of the board members is published in the annual report as provided by general company law[76]

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[75] Under the listing rules issued by the Copenhagen Stock Exchange, Part II, paragraph 3, section 19, issuers that adopt share-based incentive programs must immediately disclose certain information with respect to such programs. The disclosure obligation must include, as a minimum, information on (i) the type of the share-based incentive program used, (ii) the categories of individuals included in the program, (iii) the time of the grant of rights, (iv) the aggregate number of shares underlying the program and the allocation of such shares among the categories of individuals included, (v) the goals pursued by the program, (vi) the period within which rights under the program may be exercised, (vii) the exercise price, (viii) any particular conditions that will have to be met in order for the beneficiaries to exercise their rights, and (ix) the market value of the share-based incentive program, including a description of the valuation method and the basic assumptions underlying the valuation. Also, the adoption of extraordinary bonus programs must be disclosed.

[76] Chapter 2, para. 8, of the Accounting Ordinance which is applicable to all companies (including listed companies) provides that the following information should be published with respect to the members of the

and by the law relating to listed companies[77]. The guidelines of the Helsinki Stock Exchange recommend additional disclosure with respect to the chairman of the Board concerning the general principles applicable to bonus programmes and pension plans; termination payments, terms of notice etc.; and stock options (amount of share capital to which the options refer, vesting date, price)

(b) Prospectuses

Under the listing rules issued by the Copenhagen Stock Exchange, issuers that have adopted share-based incentive programs must provide certain information with respect to such programs when issuing prospectuses. The obligation to disclose includes information on (i) the type of program, (ii) the categories of individuals included in the same, (iii) the time of the grant of rights, (iv) the aggregate number of shares underlying the programs and the allocation of such shares among the categories of individuals included, (v) the goals pursued by the program, (vi) the period within which rights under the program may be exercised, (vii) the exercise price, (viii) any particular conditions that will have to be met in order for the beneficiaries to exercise their rights, and (ix) the market value of each share-based incentive program, including a description of the valuation method and the basic assumptions underlying the valuation. The unexercised parts of the programs must be disclosed. The adoption of extraordinary bonus programs must also be disclosed.

In Finland, prospectuses should include: aggregate data on total remuneration and benefits in kind paid to directors; total number of shares, convertible debt securities, option loans and option rights issued by the company and owned by the board members and related parties; total of loans or guarantees granted by the issuer to the board members and related parties; and disclosure on any incentive schemes directed or to be directed to the board.

3.5 Greece and Portugal

(a) Annual Disclosure

A remuneration report is neither required nor recommended in Greece. Companies limited by shares (whether listed or not) must include in the notes to the financial statements details of the compensation paid to all members of the board of directors and managers. No distinction is made as to the nature of the compensation. Termination payments must also be indicated. This information may be omitted if, through its disclosure, a member of the board of directors and his income may be identified (Section 43a of the Law 2190/1920).

Listed companies subject to the Portuguese "lex societatis" are required to publish a report on corporate governance, to be presented either as a chapter of the annual management report or as an appendix to the same report. This chapter must include details as to the remuneration of members of the board of directors' as a whole, distinguishing between executive and non-

board of directors collectively: salaries and other compensation for their duties; total amount of loans granted to them and relevant conditions; total amount of guarantees and contingent liabilities; pension commitments related to their duties.

[77] Chapter 2, para. 5, of the Regulation of the Ministry of Finance (538/2002) applicable to listed companies provides that information must be given with respect to members of the board of directors collectively on salaries and other compensation, benefits in kind, stock options and similar plans.

executive members, and between the fixed and variable parts of their remuneration (article 1/1/d of CMVM's Regulation nº 7/2001).

(b) Prospectuses

In Portugal there are no requirements as to remuneration disclosure in prospectuses, while Greece includes a general requirement as to directors' remuneration disclosure.

4. *Ad Hoc* Disclosure: Share and Share Option Transactions (1)

4.1 General

Trading in a company's shares by insiders is problematic because, in the first instance, of the insider dealing prohibition. When admitted, this trading has an informative value, as it reflects the insiders' view of the company and its future. Furthermore, insiders often sell shares that they have purchased under stock-option plans. In addition, the grant, vesting and exercise of stock-options can be influenced by the information that their beneficiaries have about the company and its performance.

All this explains why the EU Member States have adopted rules on *ad hoc* disclosure with respect to share transactions by insiders and stock-options, including the granting of the same and their exercise by the beneficiaries. These rules contribute to the prevention of insider trading, as they facilitate supervision by regulators and deter transactions which would clearly violate the insider trading prohibition. In addition, the disclosure of share transactions by insiders and of share-option plans, including the options' exercise by the beneficiaries, benefits the markets by transferring information which may be relevant to investors.

This section and the following analyse the rules on *ad hoc* disclosure applicable to share and share option transactions. The Member States are classified in two groups as done in the previous sections on annual disclosure and prospectuses. However, the analysis will show that the levels of *ad hoc* disclosure do not always coincide, for each country, with those of annual disclosure.

4.2 United Kingdom and Ireland

The UK disclosure rules with respect to share and share option transactions arise from a combination of the disclosure required of directors for all companies under ss324-328 Companies Act 1985 and the Listing Rules.

Listing Rule 16.13 requires that a company must notify a Regulatory Information Service of any information relating to interests in securities that are, or are to be, listed which is disclosed to the company in accordance with the duty of directors to disclose shareholdings under Companies Act s324 (which is extended by s328 to spouses and children) or which is entered in the company's register in accordance with Companies Act s325(3) or (4).

Section 324 (1) and (6) require that any person who becomes a director of a company at a time when he is "interested in" shares in the company (or a subsidiary of the company, or its holding company, or any other subsidiary of its holding company) commits an offence unless he discloses his interests, and the number of shares, to the company by written notice. Under s324 (2) and (6) such a person must also notify the company of any alteration (via: an event occurring while that person is a director in consequence of which the person ceases to be interested in the shares; that person entering into a contract to sell any such shares; the assignment by the person of a right granted by the company to subscribe for shares (i.e.: share option disclosure); and the grant to that person by another company in the group of a right to subscribe for its shares and the exercise of such rights (i.e.: share option disclosure)) in his interest in shares in the company ("company" as defined previously) within five working days of the alteration. The notification must state the number or amount and class of shares involved and, under the Companies Act Sch 13, Part III, the price[78]. Failure to notify is an offence (with a possible prison sentence of two years) (s324(7)).

Share option disclosure is more specifically addressed by s325. Under s325, the company is required to keep a register for the purpose of s324: but, in addition, 325(3) and (4) address share option disclosure[79]. Under s325(4), disclosure is required by the company, against the name of the director on the register, whenever the right is exercised, of the number of shares in respect of which the right was exercised, the names of the persons in whose names the shares are registered, and the number held in the name of each person[80].

Listing Rule 16.13(b) addresses disclosure by "connected persons" (defined very extensively in Companies Act s346 to cover, *inter alia*, spouse, children, a body corporate with which the director is associated, and trustees of a trust the beneficiaries of which include the director and any of the aforementioned) of directors. It provides that such a person must, unless the disclosure is already covered by 16.13(a), provide such disclosure as would be required under 16.13(a) were that person a director. The disclosure provided must track Rule 16.13(a) and identify the director, the connected person, the connection between them, and state the nature and extent (if any) of the director's interest in the transaction.

Share options are covered again under Rule 16.3(c). This provides that, unless the disclosure has already been provided under Rule 16.3(a) and (b), companies must notify a Regulatory Information Service of the following information:

- details of the grant to, or acceptance by, a director or a person connected with a director of any option (whether for the call or put or both) relating to securities of the company or of any other right or obligation, present or future, conditional or unconditional, to acquire or dispose

[78] Very detailed and all-encompassing rules apply to the determination of whether a director has an "interest" in shares under Companies Act Sch 13. In effect it is: "defined elaborately and widely. In general, it includes an interest of "any kind whatsoever [Sch 13, Part I, para 1)]" and whether actual or contingent [Sch 13, Part I, para 1-8]" (P. Davies, Gower's Principles of Modern Company Law, 6th edition, (1997) 448). Exceptions apply where shares are held by nominees or trustees: a nominee for a director will not be "interested", for example, but the director who uses a nominee will, although a director will not be "interested" when acting as a nominee for another person.

[79] In particular, the company is required, whenever it grants a director a right to subscribe for shares, to record against the director's name: the date on which the right was granted; the period during which, or time at which, it is exercisable; the consideration (where applicable for the grant); the description of the shares involved, the number, and price to be paid.

[80] In addition to the s324/325 disclosure incorporated in Listing Rule 16.13(a), disclosure is also required under Listing Rule 16.13(a) of the date on which the disclosure was made to the company; the date on which the transaction giving rise to the interest (or cessation of interest) was effected; the price, amount, and class of securities concerned, the nature of the transaction, and the nature and extent of the director’s interest in the transaction.

of any securities in the company which are or will be listed or any interest of whatsoever nature in such securities
- the acquisition, disposal, exercise or discharge of, or any dealing with, any such option, right or obligation by a director or a person connected with a director.

As with 16.3(b), the notification by the company must identify the director and, where relevant, the connected person and the nature of the connection between them, give the particulars specified above and state the nature and extent of the directors' interest (if any) in the transaction. Any notification required must be made without delay (by the end of the business day following the receipt of the information by the company). In general, under Listing Rule 16.14, any notification required must be made without delay (by the end of the business day following the receipt of the information by the company).

Listing Rule 16.16 extends the disclosure required under 16.13 where dealing has occurred in a "close period", but is permitted under the exceptional circumstances exemption set out in the Model Code: companies must include in the 16.3 notification a statement of the exceptional circumstances in the light of which dealing was permitted. The Model Code is attached to the Listing Rules and sets out a code of dealing rules designed to ensure that directors, certain employees and persons connected to them do not abuse price sensitive information, and place themselves "above suspicion", particularly during the time leading up to a results announcement. As part of this dealing code, directors are prohibited from dealing in "close periods", as defined in the Model Code.

Finally, under Listing Rule 16.17, a company must require each of its directors to disclose to it all information which the company needs in order to comply with the requirements above (so far as that information is known to the director or could with reasonable diligence be ascertained by the director), as soon as possible and not later than the fifth business day following the day on which the existence of the interest to which the information relates comes to the director's knowledge. A company must require each of its directors, at such times as it deems necessary or desirable, to confirm that he has made all due enquiry of those persons who are connected with him. A company is not required to notify a Regulatory Information Service information which, notwithstanding compliance by it with these provisions, it does not have.

In Ireland the disclosure rules with respect to share and share option transactions track the UK approach and arise from a combination of the disclosure required of directors for all companies under ss53-66 Companies Act 1990 (as strengthened by s66 of the Company Law Enforcement Act 2001 which sets out the enforcement regime) and the Listing Rules (16.3-16.17).

The rules are therefore the same as apply to UK listed companies, as ss53-66 Companies Act 1990 have the same effect as ss324-329 Companies Act 1985[81]. However, notification is to the Company Announcement Office of the Irish Stock Exchange, rather than to a "Regulatory Information Services", as in the UK[82]. In addition, the Irish Company Law Review Group has

[81] Section 53 sets out the basic obligation to notify interests in shares, this is extended by section 64 to spouses and children and by s76 of the Company Law Enforcement Act 2001 to connected body corporates, and the obligation to make certain entries in the company's register is covered under s59. The definition of interest covers, as in the UK, almost all possible legal or equitable interests.

[82] Also, the Green Pages exclude from the definition of "connected persons", for the purposes of Listing Rule 16.13(b) and (c), the parents, brothers, sisters, or adult child of a director or secretary. Finally, unlike the UK

recommended that the obligation to make a notification be disapplied where the interest falls short of 1% of the company in which the interest is held and that the disclosure obligation be a general one, as, for example, with the disclosure of interests in company contracts (First Report, para 11.10.8). It has also suggested simplification of the rules concerning what is an "interest" in shares (First Report, para 11.10.8). The Group has, however, stated that this reform would operate "without prejudice" to the Listing Rules.

4.3 France and Italy

COB’s regulation requires that company insiders (directors, supervisory board members, general managers) report to the company on every transaction executed in its financial instruments. The procedure as to how the report is made is fixed by the company.

At the end of every half-year companies must declare to the market and to the Commission (COB) the total amount of transactions executed by their insiders (Recommendation COB n° 2002-011). This will be soon a legal obligation (see : projet de loi de sécurité financière). In addition, company insiders must not execute transactions in company shares in the following periods: (i) 15 market days before and after the publication of the company’s financial statements; and (ii) from the date on which price sensitive information comes to the knowledge of company bodies to the moment of its publication (COB Regulation n. 90-04).

COB’s regulation doesn’t require timely disclosure with respect to the vesting and exercise of stock options. In fact, rules on disclosure of shares transactions executed by company insiders expressly exclude the exercise of stock options from their area of application.

According to the Italian Exchange’s Markets Rules, each company must adopt a code concerning dealings by insiders. This code gives rise to disclosure obligations in the case of transactions carried out by or on behalf of the directors, the auditors, the general managers of the company, and any other persons with access to price sensitive information[83]. The Code or the board of directors, where permitted by the Code, can prohibit or limit in specific periods of the year the dealings of the relevant persons and prescribe a mandatory disclosure for the exercise of stock options and options rights (Markets Rules art. 2.6.3; Nuovo Mercato Rules art. 2.6.3).

Companies must inform the market using the filing model available on the NIS (Network Information System) about all operations executed by the relevant persons and communicated to the company in: listed financial instruments issued by the company or its subsidiaries, excluding non convertible bonds; financial instruments, listed or not, vesting the right to underwrite, purchase or sell the above-mentioned instruments; and derivatives and covered warrants on the underlying instruments.

If the total amount of the operations for each relevant person is under 50000€ in the quarter, there are no disclosure requirements to comply with; if the total amount of the operations is between 50000€ and 250000€, the company must inform the market by the tenth business

position, company secretaries are explicitly brought within the range of the company law/Listing Rule disclosure obligation: sections 53-66 apply to persons who are a director or secretary of the company.

[83] The company must identify the relevant persons and the person in charge of the receipt, management and diffusion of the information to the market, specify the conduct and disclosure requirements, and set out the terms and the conditions of the transmission of the information to the company.

day following the end of the quarter; if the total amount of the operations exceeds 250000€, the company must inform the market so far as such information is known to it, without delay. The companies can choose whether the dealings on stock options are to be computed in the amount of the operations. If so, companies must indicate the dealings concerning stock options.

Companies must inform the market promptly regarding adoption of the code on dealing, the timing set for disclosure, if different from that required under law, and the eventual close period; they are also to send a copy of the code to the Italian Exchange (Markets Rules art. 2.6.4; Nuovo Mercato Rules art. 2.6.4; Markets Instructions art. IA.2.13.1; Nuovo Mercato Instructions art. IA.2.14.1). In any case, where a resolution by the board of directors is adopted, either concerning execution of the stock option plan approved by shareholders' meeting or concerning an independent (autonomous) decision (i.e. sale of shares of controlling companies or of subsidiaries), Consob recommends disclosure of the resolution and full details of the operation approved, as a significant fact, by issuing a press release to the stock exchange company, which shall immediately make it available to the public, and to at least two news agencies. The press release shall be simultaneously sent to Consob (Consob Communication 11508/2000).

4.4 Netherlands and Sweden

In the Netherlands, timely disclosure as to the possession of shares and voting rights in companies is required by article 2a WMZ. According to article 1, subsection 3, WMZ, shares include (contractual) rights to acquire shares in the company's capital. Consequently, stock options are also covered by the reporting requirements of the WMZ.

Article 2a WMZ provides that each member of the supervisory board and each member of the management board is to disclose his possession of shares and voting rights in the company, or in an affiliated company, immediately. Every change in the number of shares and voting rights a director holds must also be disclosed (by the director). Disclosure takes place by a notification to the AFM. Notifications are filed in a public register.

In Sweden, the listing agreements require disclosure of all material transactions between the company and its directors. If a stock option plan has been approved by the GM or has been made public, no information about vesting, exercise or sale is required under the listing agreements.

A specific Act requires directors to report all trading in the company's shares (*lagen om anmälningsskyldighet*) to a register run by the Swedish Financial Supervisory Authority (*Finansinspektionen - FI*). The director must report the options' vesting, exercise and sale of the relevant shares. The register is public.

5. *Ad Hoc* Disclosure: Share and Share Option Transactions (2)

5.1 Germany and Austria

Section 15a of the German Securities Trading Act provides that transactions (purchase or sale) in securities (even those which assign the right to buy or dispose of shares) of their own company - or of a parent company of the issuer - carried out by members of the management or supervisory board of exchange-listed companies shall be reported to the issuer and the German Financial Supervisory Authority and published without delay. This disclosure requirement applies also to spouses, registered partners and relations in the first degree of the members of the management or supervisory board.

The same section makes an important exception as it provides that the disclosure requirement does not exist if the purchase is carried out on the basis of an employment contract or as part of the remuneration arrangement. On this particular point, the supervisory authority has stated that exemptions from the disclosure and publication requirement therefore exist for the purchase of employees' shares, e.g. in the context of an equity participation program; and that the granting of stock options on the basis of an employment contract is also exempt from the disclosure requirement. However, the same document provides that the options' future exercise is in fact subject to the disclosure requirement (*BAFin* Circular 5.9.2002).

The same provision has been recently introduced in the Cromme Code (6.6) which provides that the purchase or sale of shares in the company or of related purchase or sale rights (e.g. options) and of rights directly dependent on the stock market price of the company by members of the management board and supervisory board of the company or its parent company and by related parties shall be reported without delay to the company. It is also specified that the company shall then publish the disclosure without delay.

In Austria, members of the management board, the supervisory board and senior management shall report any purchases or sales of shares in the company within seven days to the company and to the financial market authority, stating the volume held[84]. There is no obligation to disclose these facts also to the public. However, according to the Corporate Governance Code the management board shall disclose without delay any ad hoc report regarding the acquisition and sale of shares by management board members or supervisory board members on the company's website. This information shall remain on the website for at least three months (CG Code 69).

5.2 Spain, Belgium and Luxembourg

In Belgium and Luxembourg, there are no specific requirements as to the disclosure of share and share option transactions.

In Spain, RD 377/1991 requires that directors of listed companies communicate to the relevant company, to the Stock Exchanges where the company is listed, and to the Spanish Securities and Exchange Commission, any shares and stock options that they hold in the company, including any acquisition or transfer thereof. The communication must be made within seven days from either the appointment as director or the acquisition, transfer, or contract that grants the stock options[85]. In addition, the managers[86] of a listed company must

[84] The buying and selling of stocks where the market value of the change in the portfolio does not exceed EUR 10,000 is exempt from this rule; all stocks bought or sold within one calendar year shall be added together (section 91a Stock Exchange Act; CG Code 19).

[85] This duty does not concern the EU companies incorporated under the laws of a member state that are listed in one or more EU Stock Exchanges and in a Spanish Stock Exchange. Nevertheless, these companies will have to forward the communications that have been made pursuant to EU Directive 88/627/CEE in their home countries within seven days from the reception of the same.

communicate to the Spanish Securities and Exchange Commission and disclose to the market the stock option schemes and any other scheme related to shares in the company of which they are beneficiaries.

5.3 Denmark and Finland

Under Article 37 of the Danish Securities Trading Act, shares of a company held by insiders (including members of the board of directors and the management board) and by related persons must be reported to the company. Likewise, changes in the holding of such shares must be reported to the company immediately. Each trading day the company must prepare a statement showing the net result of acquisitions and disposals that day by insiders of the company. In the event the net result of trading by insiders exceeds DKK 50,000 in market value, the company is to report the information received to the stock exchange.

Moreover, the company must prepare a quarterly statement showing the holdings of shares by insiders and those associated with insiders and the aggregate holdings of shares by members of the board of directors and the board of management, respectively. This statement must show both the numbers of shares and the market value of the shares in question.

Chapter 5 of the Finnish Securities Markets Act includes rules about the registers of insider holdings and the duty to declare information to the register. The Financial Supervision Authority issued a regulation on declaration of insider holdings and on registers. The Helsinki Stock Exchange also issued guidelines for insiders.

5.4 Greece and Portugal

Under Greek law, directors and high ranking employees, in addition to complying with the rules foreseen by the EC Directive on important shareholdings, have to inform the Athens Stock Exchange about any share transaction if within one day the total amount involved is higher than 100.000.000 GrDr (293.470,28 EURO) (Section 5 of Presidential Decree 51/1992). In addition, the company's insiders[87] are required, during the first 30 days following the period to which the quarterly financial statements refer or during the shorter period before the publication of these statements or after they have obtained insider information, to notify the board of directors of the company of their intention to transact in the company's shares and to wait until this notification is officially published by the Athens Stock Exchange (Section 8 of the Decision Nr. 5/204/14.11.2000 of the Greek Capital Market Commission).

As to Portugal, Article 3 of CMVM's Regulation nº 7/2001 states that CMVM must be informed of the acquisition and disposal of listed shares by directors of the issuer or of its

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[86] RD 377/1991 includes amongst the "managers" managing directors or other persons performing high management functions that report directly to the Board of Directors.

[87] This concept includes the directors, the managing director, the financial director, the accounting director, the person responsible for the internal control, the director of the shareholders service department and the director of the department of corporate announcements.

parent company or of companies controlled by one of them, and by their nominees. This notification has to be made within five working days from the date of the relevant event[88].

6. Corporate Governance (1): the Remuneration Committee

6.1 The Remuneration-Setting Process

As argued in Part A, para. 1.3.3, adoption of an optimal remuneration contract is dependent on the remuneration-setting process taking place in an adversarial manner between self-interested parties seeking to maximize their interests. Governance controls should increase the possibility that this process maximizes shareholder interests, and does not become a skimming process in which the board is captured by management. In Anglo-American corporate governance two devices have been developed to reduce the risk of a board's capture: the appointment of independent directors to the board and the creation of a remuneration committee composed of non-executive/independent directors. The merits and limits of these institutions were analysed in Part A. In this section, the rules and practices governing remuneration-setting are analysed with reference to those EU Member States in which listed companies are recommended to form remuneration committees within their board of directors or supervisory board (depending on whether a one-tier or two-tier system or both are in place under national law). This analysis will show that the institutions of the independent director and the remuneration committee have been transplanted to continental corporate governance, albeit in forms which do not always correspond to the original model. In this respect, it is interesting to examine how the institutions in question were adapted to different contexts such as concentrated ownership and two-tier governance structures.

6.2 United Kingdom and Ireland

In both countries companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration (Combined Code B.2). The remuneration committee should make recommendations to the board on the company's framework of executive remuneration and its cost and should determine on behalf of the board of directors specific remuneration packages for each of the executive directors (Combined Code B.2.1) More generally, the chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration, in the same way as for other matters (Combined Code B.2.6). The remuneration committee should consult the chairman and/or managing director about its proposals relating to the remuneration of other executive directors and have access to professional advice inside and outside the company (Combined Code B.2.5).

With regard to remuneration policy, the remuneration committee should provide the remuneration packages needed to attract, retain and motivate executive directors without paying more than is necessary for this purpose, and should be aware of what comparable

[88] The following must be notified: a) the legal nature of the event leading to the acquisition or disposal and the date on which the said event was verified; b) the number of shares acquired or disposed and the number of shares owned by the declarer subsequent to the acquisition or disposal in question; c) the price of purchase or disposal of the shares in question.

companies are paying and take account of relative performance (Combined Code B.1.1 and B.1.2). But they should use such comparisons with caution, in view of the risk that they can result in an upward ratchet of remuneration levels with no corresponding improvement in performance (Combined Code, B.1.2). Remuneration committees should be sensitive to the wider scene, including pay and performance conditions elsewhere in the group, especially when determining annual salary increases (Combined Code B.1.3). The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels (Combined Code B.1.4).

Remuneration committees should consist exclusively of non-executive directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement (Combined Code B.2.2).

6.3 France, Italy and Spain

Under French law, the board of directors can create special committees for specific purposes (Art. 93, *Décret* n. 67-236) while best practice recommends the creation of a remuneration committee (Bouton Report). In the one-tier governance system the executive directors' remuneration is fixed by the board of directors acting on a proposal from the compensation committee (Art. L.225-45, L.225-47 and 225-53, *Code de Commerce*; Art. 93, *Décret* n. 67-236; Bouton Report*,* p. 13 f.). In the two-tier system the "*directoire*" members' remuneration is fixed by the supervisory board acting on a proposal from the compensation committee (art. L. 225 63). The remuneration committee should not include any corporate officers and should have a majority of independent directors. (Bouton Report, p. 14). A director is independent when he or she has no relationship of any kind whatsoever with the corporation, its group, or the management of either that is such as to colour his or her judgment. (Bouton Report, p. 9)[89].

The main task of the remuneration committee concerns the determination of the performance-related aspects of directors' compensation. It should fix general rules for the determination of this part of the directors' remuneration and verify every year if these rules are followed by the board of directors. The Bouton Report recommends that the general policy governing option grants be discussed within the remuneration committee and that this committee issue recommendations to the board of directors. This policy, which should be reasonable and suited to the needs of the company, should be presented in the annual report and during a general meeting of shareholders when a resolution on the granting of stock options is on the agenda (Bouton Report, p. 16). Further, the committee should be kept informed of policy

[89] The Bouton Report enumerates criteria that the committee and the board should examine in order to determine whether a director can be called independent and help avoid the risk of conflict of interests between the director and executive management. With respect to the appointment of independent directors, the Code Bouton recommends that the board of directors should always create a nominating committee, that may or may not be distinct from the remuneration committee, which "should organize a procedure designed to select future independent directors, and carry out its own research on potential candidates before they have been approached in any way" (Code Bouton, p. 17). The board of directors should review on a case by case basis the situation of each member with regard to the criteria mentioned above, then make known to the shareholders, in the annual report and at any general meeting of shareholders at which any directors are to be elected, the results of its review, so that the designation of independent directors is not carried out only by the company's executive management but by the board itself (Code Bouton, p. 8)

governing the remuneration of the main executive managers who are not corporate officers. Naturally, the committee may call upon the participation of the corporate officers in this area. (Bouton Report, p. 15).

Similarly, in Italy the board of directors determines executive directors' remuneration upon a proposal of the remuneration committee, after consulting the board of auditors (Art. 1.2 Corporate Governance Code)[90]. This committee also submits proposals on the remuneration framework for the company's senior management (Corporate Governance Code art. 8.1). The Corporate Governance Code specifies that the majority of the remuneration committee's members should be non-executive directors. Executive directors could, therefore, also be members of the committee. However, they will abstain from voting on resolutions concerning their own remuneration. As a matter of practice, in some companies most of the remuneration committee's members are independent, in the sense that they have no material relationships with the company which may influence their objectivity (Corporate Governance Code artt. 3.1, 8.1) [91].

In Spain, the Olivencia Report recommended the formation of a remuneration committee to assist the board in setting and supervising the remuneration policy for directors and senior executives. This Report suggested that board committees, such as the remuneration committee, should consist only of non-executive directors with a proportion between "domanial" (i.e. non-executive directors representing the controlling shareholders) and independent directors similar to that found on the board. The Aldama Report also recommends that listed companies establish an appointment and remuneration committee (*Comisión de Nombramientos y Retribuciones*) whose members should be chosen in accordance with the proportion of non-executive directors (Domanial and Independent) on the board. This committee should report to the board on appointments, re-elections, dismissals and remuneration of directors and on the remuneration policy for the board and top management. The board of directors is to adopt rules for the operation of the remuneration committee, which are included in its by-laws (*Reglamento del Consejo de Administración*).

6.4 Belgium, Luxembourg and Netherlands

The Belgian Corporate Governance Recommendations suggest the formation of a remuneration committee made up of a majority of non-executive directors. Executive directors can, therefore, also be members of the committee, the formation of which should be disclosed in the annual report. Similarly, in Luxembourg the appointment of a remuneration committee by the board of directors is strongly recommended by the Stock Exchange and is

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[90] The recent company law reform (which will enter into force on the 1st January 2004) has introduced two new governance systems (one-tier and two-tier), in addition to the system traditional in Italy consisting of a board of directors and a board of statutory auditors. However, the Corporate Governance Code must still be amended so as to reflect also the new systems.

[91] A director is independent if he has, or has recently had, no direct or indirect business relationships, including on behalf of third parties, with the company, its subsidiaries, the executive directors or the shareholder or group of shareholders who controls the company of a significance such that his objective judgement is influenced; furthermore he should not own, directly or indirectly or on behalf of third parties, a quantity of shares enabling him to control the company or exercise a considerable influence over it nor participate in shareholders' agreements to control the company; he is also not allowed to have immediate family relations with members of executive directors of the company or of persons in the situations referred above (Corporate Governance Code 3.1).

becoming common practice for listed companies[92]. In the Netherlands a similar approach applies. The Dutch Peters report recommends the establishment of a remuneration committee to assess all forms of remuneration, stock options, pension rights, termination payments and liability insurances. This committee should consist of supervisory board members and report its findings and make recommendations to the full supervisory board. Its existence should be reported in the annual financial report. It is expected that the 2003 Corporate Governance Committee will further elaborate on the role of the remuneration committee and its membership.

6.5 Austria and Germany

The Austrian Corporate Governance Code generally provides that the supervisory board is to set up expert committees from among its members depending on the specific circumstances of the enterprise and the number of supervisory board members. The human resources committee, if any, will be responsible for the remuneration of the management board[93]. The chair of the human resources committee will always also be the chair of the supervisory board. Where there are less than six members of the supervisory board (including employees' representatives), this committee's function may be assumed jointly by the board. The human resources committee may also act as the strategy committee. The Code provides that the rights of co-determination of employees' representatives are to apply to all committees of the supervisory board; however, the committee responsible for employment contracts with management board members may be set up without employees' representatives.

Similarly, in Germany the Cromme Code does not expressly require that a remuneration committee be created; it indicates, however, that this is good practice for many corporations. Depending on the individual company and the number of its members, the supervisory board is to form committees (5.3.1 Cromme Code). The subjects which can be delegated to and handled by one or several committees include the compensation of the members of the management board (Cromme Code 5.3.3). All members of the supervisory board are independent, but only to the extent that they cannot be, at the same time, members of the management board. Former members of the management board or employees may, however, be members of the supervisory board. According to the Cromme Code (5.4.2) not more than two former members of the management board can be members of the supervisory board and members of the supervisory board are not to hold directorships or similar positions or engage in advisory tasks for important competitors of the enterprise. In addition, all committees that handle contracts with members of the management board are to be chaired by the chairman of the supervisory board (Cromme Code 5.2).

7. Corporate Governance (2): Shareholder Monitoring

7.1 Role of the Ownership Structure

[92] Remuneration committees comprise one or more independent directors and either make proposals to the board or, if so entrusted by the board, set executive remuneration directly.
[93] The committee is to deal with human resources issues relating to management board members and also with succession planning. In particular, the committee is to decide on the terms of employment contracts with management board members and on their compensation.

Para. 1.3.3 of Part A argued that shareholders could represent an important direct monitor on whether an optimal incentive contract is adopted and that the mechanisms available to shareholders include removing directors (in the case of inappropriate pay decisions) and voting on pay policy or particular pay packages. This is particularly relevant for diffuse ownership companies, where institutional investors are often regarded as potentially strong corporate monitors, despite the well-known problems of shareholder activism. In the case of concentrated ownership companies, strong blockholders can influence the setting of executive pay through mechanisms such as the control of the board's majority and close ties with the executive directors. Therefore, the minority shareholders need to be protected from the abuses of controlling shareholders, particularly when they are also managers of the company. Clearly, discussion of company remuneration policy in the shareholder general meeting can benefit minorities by exerting pressure on the dominant blockholders. However, the role of the general meeting is different when ownership is diffuse and institutional investors own a large percentage of the share capital. This may explain why continental countries attribute a limited function to the general meeting with reference to executive pay, while the UK has recently enhanced the role of this meeting, as shown below.

7.2 United Kingdom and Ireland

As stated in para. 2.2 of this Part, the UK Companies Act now provides that a directors' remuneration report must be published on a yearly basis and laid before the general meeting of shareholders for approval. The fact that shareholders are called to an "advisory" vote on the company's remuneration policy is apt to enhance shareholder activism in this area, as confirmed by recent actions taken by institutional investors in the annual meetings of large UK companies (see Part A, para. 1.3.3 (b)).

In addition, both in the UK and in Ireland, employees' share schemes and long-term incentive schemes are subject to shareholder approval under the Listing Rules. The following schemes must be approved by an ordinary resolution of the shareholders of the company in general meeting prior to their adoption: (i) an employees' share scheme if the scheme involves or may involve the issue of new shares; and (ii) a long-term incentive scheme in which one or more directors of the issuer is eligible to participate (Listing Rule 13.13)[94]. With respect to these schemes, a number of disclosure rules apply under Listing Rule 13.14[95]. A resolution

[94] These requirements do not apply to the following long-term incentive schemes: (i) an arrangement under which participation is offered on similar terms to all or substantially all employees of the issuer or any of its subsidiary undertakings whose employees are eligible to participate in the arrangement (provided that all or substantially all employees are not directors of the issuer); and (ii) an arrangement in which the only participant is a director of the issuer (or an individual whose appointment as a director of the issuer is in contemplation) and the arrangement is established specifically to facilitate, in unusual circumstances, the recruitment or retention of the relevant individual. Where the above two circumstances apply the following information must be disclosed in the first annual report published by the issuer following the date on which the relevant individual becomes eligible to participate in the arrangement: the information required under Listing Rule 13.14 (a)-(d)(see text below); the name of the sole participant; the date on which the participant first became eligible to participate in the arrangement; explanation of why the circumstances in which the arrangement was established were unusual; the conditions to be satisfied under the terms of the arrangement; and the maximum award(s) under the terms of the arrangement or, if there is no maximum, the basis on which awards will be determined. (Listing Rules 13.13A).

[95] The circular to shareholders in connection with the approval of an employees' share scheme or a long-term incentive scheme must: include either the full text of the scheme or a description of its principal terms (13.14(a)); include, where directors of the company are trustees of the scheme, or have a direct or indirect interest in the trustees, details of such trusteeship or interest (13.14 (b)); state that the provisions (if any) relating

approving the adoption of an employees' share scheme or long-term incentive scheme may authorise the directors to establish further schemes[96].

With regard to discounted option arrangements, a listed company may not, without the prior approval by an ordinary resolution of the shareholders of the listed company in general meeting, grant to a director or employee of the issuer or of any subsidiary undertaking of the issuer an option to subscribe, warrant to subscribe or other similar right to subscribe for shares in the capital of the issuer or any of its subsidiary undertakings, if the price per share payable on the exercise of such an option, warrant or other similar right to subscribe is less than whichever of the following is used to calculate the exercise price: the market value of the share on the date when the exercise price is determined; the market value of the share on the business day before such date; or the average of the market values for a number of dealing days within a period not exceeding 30 days immediately preceding such date (Listing Rules 13.30)[97].

7.3 Continental Europe

In continental countries the role of the shareholder meeting is generally limited to the adoption of stock option plans. A shareholder resolution is mainly required to the extent that the plan involves the issue of new shares when the options are exercised[98]. Similarly, stock

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to: the persons to whom, or for whom, securities, cash or other benefits are provided under the scheme (the "participants"); limitations on the number or amount of the securities, cash or other benefits subject to the scheme; the maximum entitlement for any one participant; the basis for determining a participant's entitlement to, and the terms of, securities, cash or other benefit to be provided and for the adjustment thereof (if any) in the event of a capitalisation issue, rights issue or open offer, sub-division or consolidation of shares or reduction of capital or any other variation of capital: cannot be altered to the advantage of participants without the prior approval of shareholders in general meeting (except for minor amendments to benefit the administration of the scheme, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants in the scheme or for the company operating the scheme or for members of its group) (13.14(c)); state whether benefits under the scheme will be pensionable and, if so, the reasons for this (13.14(d)); if the scheme is not circulated to shareholders, include a statement that will be available for inspection: from the date of the dispatch of the circular until the close of the relevant general meeting, at a place in or near the City of London or such other place as the FSA may determine; and at the place of the general meeting for at least 15 minutes prior to and during the meeting (13.14(e)); and comply with the relevant requirements of the contents of all circulars (13.14(f)). The resolution contained in the notice of meeting accompanying the circular must refer either to the scheme itself (if circulated to shareholders) or to the summary of its principal terms included in the circular. (Listing Rules 13.15)

[96] They should be based on any scheme which has previously been approved by shareholders but modified to take account of local tax, exchange control or securities laws in overseas territories, provided that any shares made available under such further schemes are treated as counting against any limits on individual or overall participation in the main scheme (Listing Rules 13.16).

[97] These provisions do not apply to the grant of an option to subscribe, warrant to subscribe or other similar right to subscribe for shares in the capital of the issuer or any of its subsidiary undertakings: under an employees' share scheme pursuant to the terms of which participation is offered on similar terms to all or substantially all employees of the issuer or any of its subsidiary undertakings whose employees are entitled to participate in the scheme; or following a take-over or reconstruction, in replacement for and on comparable terms with options to subscribe, warrants to subscribe or other similar rights to subscribe held immediately prior to the take-over or reconstruction in respect of shares in either a company of which the issuer thereby obtains control or in any of that company's subsidiary undertakings (Listing Rules 13.31). Where shareholders' approval is required, the following information must be circulated to shareholders: details of the persons to whom the options, warrants or rights are to be granted; a summary of the principal terms of the options, warrants or rights; and details of the relevant requirements of the contents of all circulars (Listing Rules 13.32).

[98] For instance, in Germany stock options are subject to the power of the general meeting to raise capital. Section 192 Stock Corporation Act provides that the general meeting may adopt a resolution on a contingent

grants need to be approved by the shareholders if new shares are issued. Therefore, it is the issue of new shares and not the adoption of an incentive scheme that requires shareholder approval. However, the fact that shareholders are called to a vote may have an impact on the company's remuneration policy, particularly where the board must justify the incentive plan proposed to the shareholders and this requires *ex ante* disclosure of the main elements of the plan[99].

French law is rather distinctive in this context, as it requires a shareholder resolution (to be adopted on the basis of a report by the auditors) for all stock option plans, independently of whether the share capital is to be raised or not. The general meeting of shareholders authorizes the granting of options, sets their maximum number and determines the main conditions of the same (Art. L. 225-177). The board of directors specifies the conditions of the stock options program[100].

8. Concluding Remarks

The role of public regulation is relatively important for disclosure of executive pay, while best practices and private codes generally have some impact on the way in which executive compensation is set for listed companies. Moreover, the ownership structure of these companies is to some extent reflected by regulation, particularly given that the remuneration problem is more acute in diffuse ownership systems. This may help to explain why both public and private rules on executive pay appear to be more developed in the UK and Ireland than in the continent of Europe. Similarly, the lower level of ownership concentration in France may explain why the French regulatory model in this area is closer to the British model than to the German one.

On the whole, there is some convergence in continental Europe towards the Anglo-American model. The merits of full disclosure of executive remuneration are increasingly acknowledged in corporate governance codes and reports, while the use of remuneration committees is on the rise in the continent. This is not to say that corporate practices as to executive remuneration will soon be uniform. On the one hand, many companies still refuse to implement the principle of full disclosure even in countries where the same is recommended as best practice; on the other, institutions like the remuneration committee are not easily transplanted in systems which are characterized by concentrated ownership or two-tier governance structures. In addition, the role of the shareholder meeting in the remuneration setting process is still debatable, particularly with respect to concentrated

capital increase also to grant employees and members of the management board rights to new shares. However, the par value of contingent capital may not exceed ten per cent of the share capital as at the date of the adoption of the resolution. In addition, section 193 provides that in the case of a contingent capital increase the general meeting determines the purpose of the contingent capital increase, the persons entitled to subscribe the new shares, the issue price or the basis on which such price is to be computed and, if the persons entitled to subscribe are directors, the performance that shall be achieved, the periods in which the options can be granted and exercised and the period of lock up (at least two years).

[99] For instance, in Italy, where a resolution by the shareholders' meeting is required, a directors' report on the relevant operations must be available to the public at the registered office of the company and at the stock exchange company at least fifteen days before the shareholders' meeting. Consob recommends that the report specify the reasons for the transaction, the offerees, the price of the issue, the specific conditions of the plan, and the amount of the increase, enclosing the plan, where available, in the report (Consob Regulation 11971/1999 artt. 66, 72, 73, Annex 3A Schemes 2-4; Consob Communication 11508/2000).

[100] These conditions can prohibit the immediate resale of the shares or part of them. However, the prohibition must not last for more than three years from the exercise of the options (*Code de Commerce*, Art. L225-177).

ownership structures. Furthermore, adopting principles such as that of full disclosure and institutions like the remuneration committee also requires the introduction of detailed and efficient regulations in the relevant areas and their consistent implementation. Otherwise, convergence will be purely nominal and path dependence will prevail, as often seems to be the case in corporate governance.

C PAY PRACTISES ACROSS EUROPE

Disclosure requirements for directors' and, in particular, executives' remuneration differ across Europe and have been increasing in recent years, following the adoption of corporate governance codes in many countries. The purpose of this section is to provide a comparison of pay practices across Europe. The degree of remuneration disclosure has been checked for those companies of the countries considered which are included in the FTSE European Index Series, as reported in the FTSE monthly report December 2001. The data collected refer to a smaller sample - the constituents of the Index FTSE Eurotop300 as of December 2001 and/or December 2002[101] . The primary data source is the 2001 fiscal year annual report.

1. United Kingdom and Ireland

There were 133 UK and 11 Irish companies in the FTSE European Index Series at December 2001. The annual reports of all of these companies contain a statement as to company remuneration policy and details of the remuneration paid to each executive and non-executive director for the fiscal year 2001. The same information is reported for the year 2002. The main difference in terms of executives' remuneration policy between the UK, on the one hand, and the other European countries analysed, on the other, concerns long-term incentive plans. Short-term incentives are based on bonuses related to company performance and to executives' personal success. Long-term incentive schemes are represented in most of the countries examined by stock option plans[102], which, compared to UK stock option plans, have only been adopted in recent years. Long-term incentive plans in the UK include both a share based element and a share option element. In fact, the purpose of remuneration policy is not only to maintain a competitive pay package (an objective also stated by companies in the other countries examined), but also to motivate directors to achieve long-term strategic objectives. Long term motivation is promoted by the adoption of share-based compensation schemes such as performance share schemes, deferred equity transfers, conditional awards of shares, etc, and schemes designed to encourage the executive to invest in the company's shares through transfers of shares/deferred rights to acquire shares that depend upon company's performance over a two/three years period. The amounts of these share awards to directors are always indicated in the remuneration reports, but their value is reported in only a few cases. The total executives' remuneration shown in the tables does not contain this long-term remuneration. Moreover, the tables relating to stock options plans, below, collect only the information regarding stock option grants, in order to compare these data with those collected for the other countries examined.

Data has been collected for 68 UK companies and 5 Irish companies, all of which are included in the FTSE Eurotop300 index. All companies report on the composition of executives' pay and disclose information about incentives plans (stock options, etc).

[101] The only exception is Italy, for which companies of the Mib30 and Midex indices have been considered, since for these companies data were collected also for other purposes.
[102] Stock Appreciation Right plans are adopted as an alternative to share option plan in countries where securities or tax laws prevent or restrict the use of the executive share option schemes.

Number of companies	UK	IRELAND
Total	68	5
Bonus and other incentives	68	5
Stock option plan	68	5

The tables in the following pages provide summary statistics for the level and composition of executives' pay and for stock options granted in the UK and Ireland (this information is reported separately for the Chief Executive Officer and other executives). All the amounts are in Euro.

1.1 Executive Remuneration

UK

CEO	Companies that report this information	Mean	Median
only Total amount	All	1542403	1252515
Fixed portion	All	805119	763889
as % of Total Remuneration		56.28%	57.87%
Variable portion	All	660655	402703
as % of Total Remuneration		33.30%	32.37%

Other Executives	Companies that report this information	Mean	Median
only Total amount	All	875924	751351
Fixed portion	All	482850	450676
as % of Total Remuneration		58.03%	60.66%
Variable portion	All	352416	248649
as % of Total Remuneration		31.49%	31.20%

UK

CEO remuneration- by Industries			
SECTOR	Number of companies*	Mean	Median
Resources and Basic Industries	11	1933644	1622973
General Industries	2	1097297	
Consumer Goods	13	1906368	1383784
Services	19	1487877	1032432
Utilities	5	971919	1062162
Financials	15	1528783	1279730
Information technology	1	728378	
Total	66		
Remuneration other Executives- by Industries			
SECTOR	Number of companies*	Mean	Median
Resources and Basic Industries	11	975486	862162
General Industries	2	745676	746622
Consumer Goods	13	959469	764865
Services	19	900997	848649
Utilities	5	572917	551351
Financials	15	954332	800000
Information technology	1	426014	442568
Total	66		

* We have excluded from this table Elsevier and Unilever, since directors' emoluments published by Elsevier NV and Unilever NV include any entitlement to fees or emoluments from either Reed International or Elsevier and Unilever NV or Unilever plc.

Total pay is defined as the sum of salaries, bonuses, and benefits in kind received by the executives during the fiscal year. The average total cash compensation for the CEO in the UK is 1,542,403 Euro, while the median is 1,252,515. The other executive directors are paid on average 875,924 Euro.

The table also shows the average composition of CEO and corporate officers' remuneration. The short-term bonus represents 33,3% of total CEO pay and this percentage is 31,49% for the other executives. The ratio 'annual bonus/basic salary' (not shown in the table) is about 78% for the CEO and 68% for the other executives. These percentages are higher compared to other countries (about 60% in France and Netherlands, 47% in Sweden for the CEO).

Median and average total pay are quite high in all sectors: the Financials and the Consumer Goods sectors have the highest percentage of variable pay for both the CEO and the other executives (around 38%, not shown here).

Given the small sample of Irish companies (5 in total: one belonging to the Basic Industries sector, one to the Services sector and 3 Financial companies), a table is not reported. However, the CEO receives an average annual pay of 969,200 Euro. The base salary represents 56,32% of this amount and the ratio 'annual bonus/base salary' is 47,8%. The average total compensation for other executives is 524,000 Euro, 64% of which represents base salary and the ratio of annual bonus/base salary is 46%.

1.2 Stock Option plans

UK

All the UK companies examined have adopted stock option schemes since the '80s. The Remuneration Report includes details as to the options granted to directors; the Notes to the Accounts also give a summary of movements in share options during the fiscal year. Under executive share option plans, option awards are subject to the satisfaction of performance conditions[103]. The first table below reports: the total number of outstanding CEO, employee and management share options (OUTCEO, TOTOUT, OUTMNG); the total number of share options granted during the year, and the number of options granted to the CEO and other executives (TOTGR2001, CEOGR2001, MNGR2001). The second table gives an idea of the fraction of options held by the executives with respect to the total outstanding (OUTMNG/TOTOUT), the fraction of options held by the CEO with respect to the other executives (OUTCEO/OUTMNG), the proportion of options granted during the year to executives with respect to the total granted (MNGR2001/TOTGR2001), and the proportion of options granted to the CEO with respect to those granted in total to executives (CEOGR2001/MNGR2001). Finally, the last column shows the percentage of options granted to executives during the year with respect to total management options outstanding.

	OUTMNG	MNGR2001	OUTCEO	CEOGR2001	TOTGR2001	TOTOUT
Mean	3732525	1399890	1276483	551593	23761620	96864153
Median	2213297	635964	557147	200746	9725767	30445064
Min	10641	1192	2537	1117	61365	2603117
Max	61603469	27756660	16085639	8948100	204000000	2179379562

OUTMNG/TOTOUT	OUTCEO/OUTMNG	MNGR2001/TOTGR2001	CEOGR2001/MNGR2001	MNGR2001/OUTMNG
9.44%	42.38%	15.64%	37.32%	37.67%
6.21%	29.96%	5.44%	29.55%	32.14%
0.03%	0.00%	0.00%	0.00%	0.00%
76.12%	605.40%	213.29%	485.68%	242.65%

The average number of options granted to executives with respect to the total outstanding is about 10%, while the percentage of options held by and granted to the CEO with respect to the options held by and granted to executives are respectively 42,38% and 37,32%. 37,67% of the management options have been granted to the executives during the financial year (MNGR2001/OUTMNG).

IRELAND

One of the five companies for which data have been collected has not issued options during the year to any of the directors and has granted 50000 share options to each non-executive director. The other companies have granted on average to the CEO 50,32% of the total options granted to executives and the CEO holds 39,1% of the total options held by executives. Options held by executives represent 8% of total options outstanding and only 1,55% of these are represented by options granted to executives in 2001.

[103] This is the case also for some companies in other countries: France and Netherlands, Austria.

1.3 Non-executives directors

UK

Non-executives directors in UK are entitled to receive a basic annual fee plus additional fees for being a member of one of the board committees and for being Chairman of these committees. All the UK companies disclose the total fees paid individually to non-executive directors in the Remuneration Report. These amount on average to 62,815 Euro for each non-executive director (annual basic fee is on average 45,101). The average Chairman’s fee is 323,359 Euro and the total Chairman’s pay (including benefits and allowances) is 370,381 Euro.

IRELAND

The five Irish companies considered pay on average, to each non-executive member, a total compensation of 43,368 Euro. The Chairman receives on average 204,333 Euro.

2. France and Italy

In total, 49 French companies are included in the FTSE European Index Series at December 2001. Three of these companies report detailed, individual information on directors’ remuneration, but only in the French version of the 2001 annual report or in the *Document de Référence*. Three disclose only the amount of compensation paid to directors in aggregate.

Data has been collected on the 42 French companies, which are included in the FTSE Eurotop300 index. For 32 of these companies, it is clear from the annual report that a performance-related bonus, in addition to a fixed salary, is paid to the corporate officers. 40 companies have also adopted stock options plans in recent years (since 1997, 1999). Michelin will adopt a stock option plan in 2002.

For Italy, the companies considered are included in the Italian Indices Mib30 and Midex. All but one (Recordati) disclose the total emoluments paid to directors in the annual report 2001; in 22 cases, information on bonuses is also indicated: 6 companies pay a variable compensation only to CEO and/or General Director. 25 companies have adopted stock option plans in the recent years (mostly in 1999-2000); few will adopt one in the near future.

Number of companies	FRANCE	ITALY
Total	42	44
Bonus and other incentives	32	22
Stock option plan	40	25

The following tables provide a view of the level and composition of executives' pay as well as of the stock options granted, by country and industry. For France, this information is reported separately for the Chief Executive Officer and for the other executives; for Italy, data refer to Top Executives Officers (Presidente and Amministratore delegato). All the amounts are in Euro.

2.1 Executive Remuneration

FRANCE

CEO	Companies that report this information	Mean	Median
only Total amount	39	1826719	1633287
Fixed portion	21	908542	776689
as % of Total Remuneration		51.00%	49.59%
Variable portion	21	928047	880673
as % of Total Remuneration		47.20%	49.45%

Other Executives	Companies that report this information	Mean	Median
only Total amount	29	1022334	882325
Fixed portion	13	575843	541786
as % of Total Remuneration		47.29%	
Variable portion	13	681831	610406
as % of Total Remuneration		48.89%	

FRANCE

CEO remuneration- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	7	1795181	1746389
General Industries	5	1460064	1312666
Consumer Goods	11	1790954	1158681
Services	8	2346018	1713340
Utilities	1	1052983	1052983
Financials	5	1424750	1593001
Information technology	2	1949092	1949092
Total	39		
Remuneration other Executives- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	5	1127050	943000
General Industries	3	1156309	1155892
Consumer Goods	9	970319	775887
Services	6	928694	817248
Utilities	1	547799	494023
Financials	4	1419069	1164522
Information technology	1	1030181	779469
Total	29		

Total pay is defined as total compensation and benefits of any nature received during 2001. The average total compensation for the French CEO is 1,826,719 Euro, while the median is 1,633,287. Each corporate officer, other than the CEO, earns on average 1,022,334 Euro.
The table shows the average composition of CEO and corporate officer remuneration. The variable portion (performance-related bonus) is usually based on company performance and on the attainment of personal objectives. For the CEO, it represents 51% of total pay.
Median and average CEO total pay are somewhat higher in the Services and Basic Industries sectors. We have also noticed that in the Financials sector, the bonus represents a higher percentage of CEO total compensation.

The average total compensation for Italian Top Executives (Presidente and Amministratore delegato) is 988,649 Euro; higher values for the average and the median total pay are observed in the Consumer Goods sector. Bonuses represent 34,54% of the total remuneration.

ITALY

Top executives (Presidente and Amministratore delegato)			
	Companies that report this information	Mean	Median
Total pay	44	988649	827373
Emoluments	44	697065	515728
as % of Total Remuneration		46.94%	53.77%
Bonus and other incentives	16	432951	388000
as % of Total Remuneration		34.54%	29.81%

Top Executives Remuneration- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	6	634397	584500
General Industries	2	1104592	961105
Consumer Goods	7	1575183	1103000
Services	10	1133784	917279
Utilities	3	423787	301093
Financials	16	842705	850141
Information technology	0		
Total	44		

2.2 Stock Option plans

FRANCE

Most of the 40 French companies that have adopted stock option plans, indicate in the annual report the number of stock options granted to and exercised by the CEO, top executive officers (CEOGR2001, MNGR2001), and the 10 employees who received/exercised the largest number of options during 2001 (not reported here); the total number of outstanding employee and management stock options (TOTOUT, OUTMNG) and the total number of options granted in 2001 (TOTGR2001). However, only a few companies disclose the total number of CEO outstanding stock options (OUTCEO). These numbers are shown below.

	OUTMNG	MNGGR2001	OUTCEO	CEOGR2001	TOTGR2001	TOTOUT
Companies that disclose this information	26	35	7	34	38	40
Mean	2561270	645846	550901	234094	5249839	14195588
Median	1027525	370500	269286	141250	2814938	5648911
Min	134596	15000	140000	14314	5900	1272543
Max	7558800	2275330	2295640	900000	68931051	114137939

	OUTMNG/TOTOUT	MNGR2001/TOTGR2001	CEOGR2001/MNGR2001	MNGR2001/OUTMNG
Mean	18.41%	20.11%	39.72%	29.43%
Median	15.25%	15.82%	37.09%	26.86%
Min	1.80%	0.32%	10.14%	7.14%
Max	49.65%	68.57%	87.73%	74.08%

Alcatel has 114,137,939 total outstanding options as of 31 December 2001 and is the company that granted the highest number of options to corporate officers (MNGR2001). The average number of options granted in 2001 to management is 645,846, which represents 20,11% of total options granted in 2001. Options granted to the CEO correspond to 39,72% of total options granted to the management. Moreover, 29,43% of total management options have been granted in 2001 (MNGR2001/OUTMNG).

ITALY
Most of 25 Italian companies that have adopted stock option plans report the amount of options granted to Top Executives (CEOGR2001) and to managers (MNGR2001), and the amount of total outstanding options. Information about the total number of outstanding management options is not available.

	MNGGR2001	CEOGR2001	TOTGR2001	TOTOUT
Companies that disclose this information	20	23	18	21
Mean	1748233	626859	15020945	17359429
Median	711100	239218	2596250	4945500
Min	50600	5566	303911	219700
Max	4539800	4747000	67025000	126866650

	MNGR2001/TOTGR2001	CEOGR2001/MNGR2001	MNGGR2001/TOTOUT
Mean	31.95%	35.86%	47.84%
Median	23.99%	32.06%	11.91%
Min	2.73%	0.16%	1.88%
Max	74.25%	81.97%	314.16%

Telecom Italia has the highest number of total outstanding options as of 31 December 2001 and has also granted the highest total number of options during the year (TOTGR2001), while Autostrade has granted the highest amount of options to management (Presidente, Amministratore delegato and Direttore generale). The options granted to management represent about 32% of the total granted in 2001 and 47,84% of the total number of outstanding options. Options allocated to Top Executives (CEOGR2001) amount to 35,86% of the total granted to executives.

2.3 Non-executive directors

FRANCE
The annual fee paid to members of the Supervisory Board in France is distributed in the following way: an annual attendance fee paid to each member of the Board of Directors/Supervisory Board, plus additional fees for being member of one of the Board Committees, for each Board/Committee meeting attended, and for acting as Chairman of the Board/Committee. 33 companies out of 42 disclose this information, individually for each non-executive director, in the annual report. The average annual compensation for each non-executive director is 34,871 Euro. This number refers to non-executives directors and members of Supervisory Board, excluding the Chairman of the Supervisory Board, whose total remuneration is on average 200,241 Euro.

ITALY

For Italy, 44 companies publish the individual remuneration paid to non-executive members of the Board of Directors. Total pay includes fixed annual emoluments plus other compensations and non-monetary benefits received during the year. Emoluments received by non-executives are on average 75,385 Euro.

	Total pay	Emoluments
Mean	103752	75385
Median	51646	36000

3. Netherlands and Sweden

18 Dutch companies are included in the FTSE European Stock Indices. All of these companies are also part of the FTSE Eurotop300 Index, and the data have therefore been collected for all of them. 2 companies disclose in 2001 only aggregate information on executives' remuneration, which is reported individually in the annual report for the fiscal year 2002. We looked at the 2002 annual reports and we have noticed that in general, the information regarding directors' remuneration, stock options, etc…is more detailed.
Moreover, all (18) specify the composition of remuneration in the 2002 reports, while for 2001 the only exceptions are the 2 companies just mentioned. Numico did not pay bonuses in 2001. Stock option plans are adopted by 17 companies: no members of the Executive and Supervisory Board in Heineken hold any of the company's shares, convertible bonds or option rights.

For Sweden, 32 companies are included in FTSE European Stock Indices and 19 are part of the FTSE Eurotop300. All Swedish firms report information on 'benefits to senior executives during the fiscal year, i.e.: fees paid to the chairman, base salary, variable remuneration, pensions, other benefits in kinds, severance payments and options allocated to the President and CEO. Two companies disclose only the total salary paid to the CEO and one did not pay bonuses in 2001. With regards to shares and options held by directors, these amounts are found in the annual reports where the names and roles of directors are listed. The information on stock option plan is not as detailed as for other countries.

Number of companies	NETHERLANDS	SWEDEN
Total	18	19
Bonus and other incentives	16	16
Stock option plan	17	16

3.1 Executive Remuneration

The summary tables below show the compensation of CEO and other executives for Netherlands, while for Sweden the data refer only to the President-CEO, which is the only information given in detail. The amounts are expressed in Euro.

NETHERLANDS

CEO	Companies that disclose this information*	Mean	Median
Total pay	14	1237354	1151700
Base salary	13	691026	675000
as % of Total Remuneration		55.56%	51.03%
Bonus	13	532681	447700
as % of Total Remuneration		31.13%	32.07%

Other Executives	Companies that report this Information*	Mean	Median
Total pay	14	898736	762000
Base salary	13	561722	526670
as % of Total Remuneration		61.96%	60.01%
Bonus	13	331747	286000
as % of Total Remuneration		31.21%	33.66%

* We have excluded from this table Elsevier and Unilever, since directors' emoluments published by Elsevier NV and Unilever NV include any entitlement to fees or emoluments from either Reed International or Elsevier and Unilever NV or Unilever plc.

NETHERLANDS

CEO remuneration- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	3	1179890	849116
General Industries	1	970295	
Consumer Goods	2	1307213	
Services	4	1238640	1057550
Utilities	0		
Financials	4	1327000	1283500
Information technology	0		
Total	*14		

Remuneration other Executives- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	3	699155	653564
General Industries	1	819248	990219
Consumer Goods	2	693048	466667
Services	4	1084188	1109184
Utilities	0		
Financials	4	1000357	858000
Information technology	0		
Total	*14		

*Emoluments of the directors of Elsevier NV and Unilever NV include any entitlement to fees or emoluments from either Reed International or Elsevier and Unilever NV or Unilever plc; for this reason we have excluded from this table data on Elsevier and Unilever.

Total pay is total compensation and benefits received during the year. The total pay of the Dutch CEO is on average 1,237,354 Euro, with a median value of 1,151,700 Euro; while other executives received in 2001 an average compensation of 898,736 Euro. The bonus represents about 31% of the total pay, both for the CEO and the other executives. The Consumer Goods sector seems to pay higher percentages of variable compensation for both the CEO and other executives.

Swedish companies provide detailed information on remuneration for the Chairman of the Board and for the President-CEO, but report on only the aggregate amounts paid to the other executives and directors. As we can see, the annual average compensation for the Swedish CEO is 952,803 and the variable remuneration is 29,92% of the total, a lower percentage compared to the countries seen (U.K., France, Italy, Netherlands).

SWEDEN

CEO	Companies that disclose this information	Mean	Median
Total pay	19	952803	913042
Base salary	16	648065	574738
as % of Total Remuneration		67.27%	69.15%
Bonus	16	304542	180071
as % of Total Remuneration		29.92%	22.56%

SWEDEN

CEO remuneration- by Industries			
SECTOR	Number of companies	Mean	Median
Resources and Basic Industries	1	759412	
General Industries	6	971716	902762
Consumer Goods	2	820093	
Services	4	914893	875901
Utilities	0		
Financials	5	865667	913042
Information technology	1	1860128	
Total	19		

3.2 Stock Option plans

NETHERLANDS

17 of the 18 companies considered adopt stock option plans. In three cases, options are also granted to members of the Supervisory Board. The description of stock option plans is quite detailed and, for most of the companies included in the sample, we managed to find information about the number of management, CEO, and total outstanding options (OUTMNG, OUTCEO, TOTOUT) as of 31 December 2001 as well as information about the number of options granted to management and CEO in 2001 (MNGR2001, CEOGR2001). These data are reported below, together with the fraction of the options held by management and CEO with respect to the total and management outstanding options (OUTMNG/TOTOUT; OUTCEO/OUTMNG). CEOGR2001/MNGR2001 gives the percentage of options granted in 2001 to the CEO with respect to the total granted to the Management Board in the same period. MNGR2001/OUTMNG is the percentage of options granted to the Management Board in 2001 with respect to total outstanding options at the end of the year 2001. Unilever and Elsevier are excluded from the sample.

	OUTMNG	MNGGR2001	OUTCEO	CEOGR2001	TOTGR2001	TOTOUT
Companies that disclose this information	15	15	15	14	7	15
Mean	1296582	699222	440478	176979	13943055	22105353
Median	832973	280000	264000	67636	8586175	22138724
Min	214000	80000	63450	20000	3557500	2427425
Max	3293334	4885000	1631398	1567398	50658000	71045915

	OUTMNG/TOTOUT	OUTCEO/OUTMNG	CEOGR2001/MNGR2001	MNGR2001/OUTMNG
Mean	8.97%	33.43%	29.46%	33.00%
Median	10.40%	31.44%	25.00%	29.22%
Min	1.89%	9.81%	10.00%	14.81%
Max	16.99%	61.69%	66.77%	88.76%

SWEDEN
It is clear from the annual reports that 16 companies have adopted a stock option plan. However, the characteristics of these programs are not detailed as for other countries. The information found for 15 companies includes the number of shares, convertible bonds, options etc, held by directors. The fraction of financial instruments (options and convertible bonds) allotted to the CEO with respect to the Management Group is reported here.

	OUTCEO/OUTMNG
N. of companies	11
Mean	28.35%
Median	19.68%
Min	2.87%
Max*	84.57%

3.3 Non-executives directors

NETHERLANDS
13 Dutch companies publish in detail the individual remuneration paid to members of the Supervisory Board, which includes directors' fees and committee fees. The numbers below refer to 11 companies; Unilever and Elsevier are excluded from the sample.

	Total fees	Directors' fees
Mean	38100	36696
Median	37700	37000

The Chairman of the Supervisory Board receives on average a total pay of 51,738 Euro.

SWEDEN
For Sweden, the 19 companies of the sample report the total fees paid to the Chairman of the board of directors, who received in 2001 on average 120,722 Euro, with a median pay of 109,800 Euro.

4. Germany and Austria

36 German companies are included in FTSE European Stock Indices. Only one of these reports the compensation paid individually to members of the Executive Board (Schering). All of the others publish the amounts paid in aggregate to the Management Board and to the Supervisory Board.
Data have been collected for the 30 companies included in the Index FTSE Eurotop300. The two tables below show, respectively, the composition of remuneration adopted by these companies and the degree of disclosure in more detail. 30 companies pay a performance-related bonus to their executives, even if only 18 report this amount, and 12 publish only the total remuneration. As an improvement in transparency has been noticed for other countries

in 2002, we have checked the degree of disclosure in the 2002 annual reports: the number of companies in the sample that publish individual remuneration has increased from 1 to 5.

GERMANY	Number of companies
Total	30
Performance-related bonus	30
Stock option plan	17
Long-term program (SAR, long-term bonus*)	7

*Stock appreciation right (SAR) entitles to a cash payment based on the difference between the reference price and the share price at the exercise date. The long-term bonus depends on the company's performance over a three-year period.

Disclose:	Number of companies
Total	30
only aggregate in 2001	29
Individual info	1
only aggregate in 2002	25
Individual info	5
Report only total compensation paid to the Executives	12
Specify the remuneration composition of the Executives	18
Report only total compensation paid to the Non-Executives	18
Specify the remuneration policy for Non-Executives	12

Similarly, the 22 Austrian companies part of FTSE Stock Indices report only on total remuneration of Managing Board and Supervisory Board; only one discloses individually the Executive Board members' remuneration, but in 2002 annual report.

4.1 Executive Remuneration

GERMANY

The numbers below represent the total, aggregate pay received on average by the Executive Board, as well as the fixed and the variable portion, that represents 52,6% of total remuneration. The table also reports the compensation received on average by each Board member, which is 1,352,537 Euro (average number of Board members being 8). This value must be interpreted with some caution because the remuneration of the CEO is included in these numbers.

Executive Board	Companies that disclose this information	Mean	Median
Aggregate total pay	30	10720962	7871000
Fixed portion	18	4320006	3446000
as % of Total Remuneration		43.33%	41.94%
Variable portion	18	7506865	4373261
as % of Total Remuneration		52.60%	53.64%
Compensation received by each member; average number of Board members: 8		1352537	1034848

AUSTRIA

The 3 companies part of the FTSE Eurotop300 index disclose the total remuneration of Executive directors, as a group (including CEO remuneration), without distinguishing between fixed and performance-related components.

Executive Board	Companies	Mean
Aggregate total pay	3	2831333
Compensation received by each member; average number of Executive Board members: 4		698778

4.2 Stock Option plans

GERMANY

Long-term incentive programs in Germany involve the allocation of options, as well as convertible bonds and stock appreciation rights; we have reported below the fraction of these financial instruments held and granted to executives in 2001 (OUTMNG, MNGR2001) with respect to the total number of rights granted in 2001 and the total number of outstanding rights (TOTGR2001, TOTOUT). Options held by the Management Board represent 17,26% of total outstanding options and 43,78% of these options have been granted in 2001.

	OUTMNG/TOTOUT	MNGR2001/TOTGR2001	MNGR2001/OUTMNG	MNGR2001/TOTOUT
Companies that disclose this information	9	16	8	15
Mean	17.26%	15.83%	43.78%	9.92%
Median	10.77%	8.43%	47.49%	4.47%
Min	4.25%	0.33%	26.50%	0.38%
Max	76.17%	87.66%	54.55%	39.45%

AUSTRIA

The 3 Eurotop companies adopt a Share option program. In one case, the only information given in the annual report is: ‘beneficiaries are granted options to acquire company’s stock on condition that certain targets are met’; only two companies disclose the amount of options held by Executives and CEO (OUTMNG, OUTCEO).

	Mean
OUTCEO/OUTMNG	30.68%
OUTMNG/TOTOUT	22.46%

4.3 Non-executives directors

GERMANY

All of the 30 companies considered publish the remuneration paid in aggregate to the Supervisory Board and 12 specify the composition of the payment. Each member received on average a total fee of 69,014 Euro in 2001 (the average number of Supervisory Board members is 18).

Supervisory Board	Mean	Median
Aggregate total fees	1257462	1290629
Compensation received by each member; average number of Supervisory Board members: 18	69014	62369

Again, these numbers refer to all members, including the Chairman. The following table shows the remuneration policy for non-executives, as specified by 12 companies (amounts reported on an average basis). Each member receives a fixed annual fee, reimbursement of out-of-pocket expenses, and a dividend-based compensation (a certain amount of Euro for each percentage point that aggregate dividends paid to shareholders in a given year exceed a certain percentage of the company's share capital); the Chairman receives on average twice this amount.

Remuneration policy for Non-Executives: (12 companies, average amounts)	Euro	n times
Fixed annual payment for each member	26511	
Chairman receives n times the annual compensation of the other members		2.0
Chairman receives Euro	50105	
Vice-Chairman receives n times the annual compensation of the other members		1.5
Vice-Chairman receives Euro	34765	

AUSTRIA

Each member of the Supervisory Board receives on average an annual compensation of 19,885 Euro.

Supervisory Board	Companies	Mean
Aggregate total pay	3	286000
Compensation received by each member; average number of Supervisory Board members: 13.6		19885

5. Spain and Belgium

SPAIN

Only 16 out of the 18 Eurotop Spanish companies disclose the total compensation received by the Board of directors in 2001; 2 companies disclose the aggregate board members' remuneration in 2002 annual report; in few cases, the type of remuneration paid (fixed and/or variable, pensions, board fees...) is also specified. Banco Popular Espanol publishes the directors' individual remuneration in 2001 and 2002 annual reports. 5 companies have recently adopted a stock option plan for executive directors; 4 operate stock appreciation rights schemes as a form of medium-incentive plan. The others either do not have in place any executive remuneration system directly or indirectly linked to the price of company's shares or to stock options, or do not give information about the executives' remuneration policy. The following table shows the data provided by the 16 companies; usually, no distinction is made between executives and non-executives members. Only 5 companies specify the total amount received by Board members as director (directors' emoluments) from the amount received as executive (executives' salary), which results to be about 519,696 Euro on average, for each executive member (average number of executives members is 5).

Remuneration

Board of Directors	Companies	Mean
Aggregate total pay	16	4230045
Compensation received by each member; average number of Board members: 15		279115

The information available on Stock option schemes is very little. Companies usually report the total amount of outstanding options and only 2 specify the number of options granted to directors (27,42% of the total options granted in 2001) and held by directors (23,63% of the total outstanding options).

BELGIUM

22 companies are part of FTSE Index series; 3 do not provide any information on directors' remuneration; 2 specify the CEO compensation in 2001 and give more details on directors' compensation policy (short and long-term incentive programs) in the 2002 annual report. All the others publish the remuneration paid to the Board of directors, executives and non-executives, as an aggregate amount and in few cases indicate the fixed and variable parts of the same. The data collected for the 11 companies included in the FTSE Eurotop300 index are reported here (amounts in Euro).

Remuneration

Executive directors	Companies that disclose this information	Mean
Aggregate total pay	11	5380305
Fixed portion	7	1987715
as % of Total Remuneration		58.16%
Variable portion	7	1339950
as % of Total Remuneration		41.84%
Compensation received by each member; average number of Board members: 8.17		730051
Non-executive directors	Companies that disclose this information	Mean
Aggregate total pay	10	1386202
Compensation received by each member; average number of Board members: 13		99182

10 companies operate long-term incentive plans (since 1999, 2000 and 2001), through the use of stock options. However, the information published on these programs is scarce: only 3 companies provide the number of options granted to directors and the total number of outstanding options.

Stock options

	Mean
MNGR2001/TOTGR2001	51.96%
CEOGR2001/MNGR2001	24.89%
MNGR2001/OUTMNG	31.54%

6. Denmark and Finland

DENMARK

In Denmark, the 7 Eurotop companies disclose only the total, aggregate amounts paid to the Management Board and to the Supervisory Board. 2 companies specify the portion of total pay represented by annual bonuses (about 18%; while the ratio bonus/fixed salary is between 20% and 35%). The bonus program is based on specific, individual annual targets including personal, financial and operational targets. Only one company provides detailed, individual directors remuneration, but in the annual report 2002. The information on Incentive Programs contained in the 2002 reports is also more precise. The table shows the average total pay received by the Executive Board and Supervisory Board in aggregate (including Chairman and CEO) and the compensation received on average by each Board member. Amounts are in Euro.

Remuneration

Executive Board	Companies	Mean
Aggregate total pay	7	2646298
Compensation received by each member; average number of Board members: 6.67		491139
Supervisory Board		
Aggregate total pay	7	474459
Compensation received by each member; average number of Board members: 9.2		38937

5 out of 7 companies have introduced incentive schemes for key employees during 1999, 2000 and 2001 (warranty programme in one case and share options schemes for the other 4). The Incentive programme launched by Danske Bank in 2001, in particular, includes four elements: share options, conditional shares, an employee share scheme and cash bonuses. Incentive payments reflect individual performance and are also linked to the financial results of individual business areas and other measures of value creation.

Stock options

	OUTMNG/TOTOUT	MNGR2001/TOTGR2001
N. of companies	4	4
Mean	27.40%	12.37%
Median	27.29%	11.98%
Min	17.90%	0.00%
Max	37.11%	25.53%

FINLAND

In Finland, companies provide detailed information on the remuneration of the chairman and the president-CEO, while aggregate, collective information on the remuneration of the other members of the Board of Directors and Executive Committee. The data collected for the 5 Eurotop companies is shown below: the annual total compensation received on average by the President-CEO is 1,077,094 Euro, 27% of which is variable; the other executives receive on average 397,004 Euro each. Nokia gives details on the level and composition of executives' compensation in 2002. The total pay for the non-executive Chairman is 159,298 Euro and 59,890 Euro, on average, for each other non-executive director. All the 5 Eurotop companies operate stock option plans.

Remuneration

Executive Board	Companies	Mean
CEO-Total pay	5	1077094
Compensation received by each member; average number of Board members: 17		397004
Supervisory Board	Companies	Mean
Chairman-Total pay	5	159298
Compensation received by each member; average number of Board members: 16		59890

Stock options

	Companies	
OUTCEO/OUTMNG	4	28.86%
OUTMNG/TOTOUT	4	13.90%
MNGR2001/TOTGR2001	2	7.97%
CEOGR2001/MNGR2001	3	42.30%
MNGR2001/OUTMNG	3	33.38%

7. Portugal and Greece

PORTUGAL

Looking at the Annual reports 2001 of the 10 companies included in FTSE European indices, only the total amount of pay given to the Board of Directors is disclosed, distinguishing sometimes between executives and non-executives directors. This is the case for 3 out of the 5 companies part of the Eurotop index, paying 49% of total pay in the form of performance-related bonus (see table below). The information contained in the 2002 reports is basically the same: it is higher the number of companies that make a distinction as to the nature of the compensation, but the amounts published are always aggregate. 3 out of the 5 Eurotop companies have adopted stock option plans for executives and directors and one of these has also other incentive schemes: allocation of free shares based on individual performance. For one company, there is no mention of long-term incentive program in the annual report, while the stock-based incentive system launched by Banco Espirito Santo in 2000 consists in the sale to employee of blocks of BES shares with deferred settlement. The information relative to Stock option plans is not very detailed and only the total number of outstanding options is available for 2001.The only exception is represented by Portugal Telecom, for which the CEO holds 10.48% of the total management outstanding options and these represent the 21.37% of the total options outstanding[104].

Remuneration

Board of Directors	Companies	Mean
Aggregate total pay	5	12766217
Compensation received by each member; average number of Board members: 15		961150
Average compensation received by each executive member; average number of executive Board members: 5.6	3	705927
Average compensation received by each non-executive member; average number of executive Board members: 6.3	3	68404

[104] Options held by members of the Board of Directors.

GREECE

Three of the 9 Eurotop companies have the Website under construction and the annual report was not available. The other 6 publish the total remuneration paid to the Board of Directors, which is on average 2,193,113 Euro; each member received on average a compensation of 148,183 Euro (average number of Board members: 14.6).

Remuneration

Board of Directors	Companies	Mean
Aggregate total pay	6	2193113
Compensation received by each member; average number of Board members: 14.6		148183
Average compensation received by each executive member; average number of executive Board members: 5.3	3	506513

These numbers do not distinguish between executives and non-executives remuneration. However, 3 companies out of the 6, indicate separately the remuneration paid to executives members of the Board. For these, the average compensation received by an executive director is about 506,513 Euro.

We checked the annual reports of the 57 industrial Greek companies included in other FTSE European indices, however for 32 of them, the website was under construction and the report was not available or available only in Greek language. All the others report the compensation paid in aggregate to the Board.

With regards to long-term incentive schemes, 5 out of the 6 Eurotop companies operate a management share option plan (launched in 2000-2001) and only 2 publish a summary of movements in share options (total number of options granted during the year, options granted to directors and total number of outstanding options). For these 2 companies, directors have been granted 29.06% of the total options granted in 2001 (MNGR2001/TOTGR2001=29.06%).

D REFORM PERSPECTIVES

1. The Winter Report

Process rules, designed to re-adjust the bargaining process, are a common feature of the reform agenda. The Winter Group followed a similar approach for company law reform in Europe by noting that "the level and form of remuneration of executive directors should be left to the companies and their shareholders" and insisting on "appropriate governance controls, based on adequate information rights" (Chapter III, para.4.2). First of all, the Group suggested that the creation of remuneration committees, made up of "non-executive or supervisory directors who are in the majority independent," be required (para.2). The Group rejected the Anglo-American requirement that remuneration committees should consist entirely of independent directors noting that "in Europe, we have to take account of particular situations relevant to board structures, like the existence of controlling shareholders and boards which are partly co-determined by employees". Moreover, the Group expressed the opinion that the EU should not adopt binding legislation in this area, as it would be "inflexible and not responsive to local and changing needs and conditions". A Commission Recommendation could be issued stating that either national company laws or corporate governance codes should adopt provisions as to remuneration committees, their composition and functioning.

In addition, the Group made the following suggestions (para.4.2):
(i) directors' remuneration policy should be disclosed in the financial statements of the company and be an explicit item on the agenda of the annual general meeting. The Group did not suggest that a vote on remuneration policy, as provided by UK company law, be required, considering that "the effects of such a vote can be different from Member State to Member State" and that "the important thing is that shareholders annually have an opportunity to debate the [remuneration] policy with the board";
(ii) the remuneration of individual directors, both executive and non-executive or supervisory directors, should be disclosed in detail in the annual financial statements of the company. Disclosure should cover all financial and non-financial benefits derived from the company, including golden parachutes and pension rights;
(iii) share grants and share options schemes, other share incentive schemes, and any substantial change in the same should be subject to the prior approval of the shareholders meeting. This approval would relate to the scheme as such and not to the individual remuneration of directors under the scheme;
(iv) the costs to the company of these schemes should be accounted for in the annual accounts, as also proposed by IASB.

On the whole, these propositions are acceptable and reflect Anglo-American best practices while taking into account some of the particular features of continental corporate governance. The use of remuneration committees is already common in a good number of EU countries, as shown in Part B, section 4: a Commission Recommendation could enhance this practice and contribute to its extension to the remaining countries. In addition, disclosure of remuneration policy is already required in some countries, even though particular national requirements differ. The implementation of the policy suggested by the Winter Report will require selecting disclosure standards for remuneration policy which are acceptable at the European level. These standards should be compatible with the capital markets' conditions and with the corporate governance structures of all Member States. From this perspective, the standards recently adopted by UK company law appear to be too demanding for other countries. The disclosure of individual remuneration is a requirement in several Member States. However, in other States a tradition of opaqueness is followed as to executive remuneration and only aggregate data are published. Presumably, the publication of detailed and individualized information in all countries will be obtained only if required by EU legislation.

2. Reform Problems

There are, however, limits to the executive pay reforms proposed, including those suggested by the Winter Group. Shareholder-focused solutions face the general difficulty of how best to promote shareholder activism given the collective action problem and, in the context of blockholding systems, particular consideration needs to be given to minority shareholder voice. Reforms based on forcing action by institutional investors, particularly in the context of dispersed ownership, seem unlikely to succeed given conflict of interest problems, coupled with a lack of consistent expertise on remuneration (raising the danger of a "box-ticking" approach),[105] and were rejected by the Winter Group, and the subsequent Commission Action Plan on Company Law, in favour of disclosure of institutional investor voting policies. The use of disclosure as a reform tool, which appears to be increasingly accepted in Europe and which crosses both governance systems with rather less difficulty (aside from cultural problems) than direct intervention in governance, requires careful consideration of the nature of the information disclosed to shareholders and the market. Ultimately, it may be that process rules and reforms can only improve the extent to which remuneration contracts are adopted in the interests of shareholders: they cannot eliminate all the difficulties from an inherently conflicted process. In this regard, some reforms suggest instead the removal of all accounting and taxation incentives which might distort the board's incentive for setting optimal remuneration in the interests of shareholders.[106]

Other reforms address design problems and seek a better alignment of shareholder and management interests by, for example, a closer focus on performance targets through the use of indexed options and the linking of option exercise to performance targets, a clearer demarcation of downside risk burdens via the elimination of repricing, and greater reliance on share, as opposed to option-based remuneration, by the grant of restricted shares rather than options. There is, however, a need for flexibility in this area. Arguably the problem is not with types of remuneration, but with the process under which it is adopted. If the process is secure, remuneration contracts should contain incentives which align incentives appropriately, whether this is required to a greater or lesser extent according to the governance system

Another reform strategy is to reject the basic premise of the performance-based incentive contract and reduce levels of remuneration artificially. Direct government intervention in the remuneration market in the form of caps on remuneration, such as a mandatory linking between executive pay and multiples of an average employee salary, is often raised as a

[105] One study has proposed that institutional investors be made accountable for voting in an informed and sensible manner and forced to act as if they were the owners of the large blocks they control: See generally R. Monks and A. Sykes, *Capitalism Without Owners Will Fail* (2002).
[106] C. Yablon, "Bonus Questions - Executive Compensation in the Era of Pay for Performance" 75 Notre Dame Law Review (1999) 271, 279, , 303-306.

reform strategy.[107] Difficulties abound with this approach, however, including the risk that employee salaries become distorted to deliver high remuneration levels.[108] The tax system can also be used via higher rate taxes and caps on the deductibility of remuneration.[109] The complexities and difficulties of this area suggest, however, that it is not possible to specify a particular form for, much less the appropriate amount of, remuneration.[110]

Ultimately, remuneration should be set by a correctly functioning market, and not by government. To the extent that regulation is imposed it should be to reset the market mechanism. As a reform strategy, regulation of process or structure carries the danger of entrenching various structural aspects of remuneration which are more appropriately left to the market which will fine-tune them over time and experiment with various types of remuneration.[111] For example, requiring the disclosure in remuneration reports of relative performance graphs which show how share values compare against peer groups (for the UK application of this practice see Part B, section 2.2), may entrench share performance as the correct indicator of performance.[112] While it may be the most effective way of aligning incentives, problems remain with the use of share values as performance indicators . Politically-driven regulatory solutions are unlikely to match or outperform the solutions adopted over time by the market for executive remuneration.[113] Law is also less adaptable. Changes made through the tax system, for example, will prove difficult to unravel if they prove damaging to executive performance and incentives. The debate on executive remuneration also continues to shift. With respect to share options, for example, while the focus in the 1980s in the US was on the greater use of share options in order to link remuneration more closely to shareholder wealth, it has now shifted to how to ensure that executives do not benefit unfairly from windfall market gains as opposed to company-specific performance. The reliance on share options is also a relatively recent phenomenon.[114] Legal solutions may therefore entrench, rather than solve, problems.

3. Conclusion

The executive pay problem can be characterized in a number of different ways which are difficult to reconcile when it comes to identifying whether there is a problem in need of reform and the appropriate solutions. This problem is exacerbated in the European context where executive pay crosses two systems of corporate governance and raises different concerns. Is executive remuneration a problem because of its level, or is it a structure and process problem in that directors are not designing remuneration in shareholders' interests? Should limits be placed on the payments made under incentive contracts, even if performance

[107] A leading UK corporate governance expert, Paul Myners, has suggested that companies compare executive remuneration over time with growth in average employee salaries, rather than with remuneration of executives at other companies: N.Cohen, "investors told to be more vigiliant" Financial Times, May 8 2003. A number of legal systems intervene more gently, with rules requiring that remuneration be "reasonable": Cheffins (2003) note * .

[108] See Murphy (1995) note * , 727-728 The point has also been made that caps rarely work in practice. Cheffins (2003) points to the Argentinian experience. While remuneration is limited to a proportion of profits, Argentinian CEOs are among the world's most highly paid. Note * , 15.

[109] Yablon (1999) note *, 274-275.

[110] Yablon (1992) note * , 1867.

[111] Yablon (1992) note *, 1889.

[112] Murphy (1995) note * , 736.

[113] M. Loewenstein, "The Conundrum of Executive Compensation" 35 Wake Forest Law LR (2000) 1i, 13.

[114] See Hall and Liebman (1997) note * .

targets are met and the incentive contract is meeting agency costs and not generating them? If problems with executive remuneration are regarded as aspects of the core dispersed ownership agency problem then light-touch regulation which addresses the incentive contract structure and process may be called for. But if the incentive anchor is removed, and the concern is with wider fairness and wealth distribution, difficult balancing questions come into play. In addition, the different constituencies involved, employees, shareholders, the public and so on, have different and often irreconcilable concerns. Executive pay can also be analyzed as exposing another fissure in the faultline between market-based and relationship-based corporate governance systems. Many of the difficulties with executive remuneration appear to stem from its problemmatic function as a troublesome remedy for dispersed ownership agency costs which has, however, the potential, in the absence of effective governance, to exacerbate agency difficulties. In this regard, it forms part of a much wider debate as to the competing advantages and disadvantages of market-based and relationship-based corporate governance.

It is easier to find problems than solutions in this field.[115] In principle, remuneration contracts are needed to encourage the risk-taking and value-generating entrepreneurs which shareholders want and economies, regardless of governance structure, need. There is certainly some doubt that the appealing theory underpinning incentive contracts is not always reflected in practice in dispersed ownership systems. This is particularly the case where gains from large share option grants appear unrelated to performance and governance problems exist. The costs of monitoring via remuneration contracts in dispersed ownership systems may, however, include the inevitability of a certain level of self-interested behaviour by directors and management which cannot be completely removed.[116] In the absence of some clear evidence of a market failure it seems dangerous to pull down the edifice of performance-related pay, particularly given that there is some evidence of a link between incentive pay and company performance.[117] Ultimately, from the dominant agency perspective, minimizing agency costs is not cost-free, but a properly structured performance-based contract, balanced as to equity-based and cash remuneration and buttressed by appropriate controls on the negotiation process, may represent one of the best ways to align shareholder and management interests in the context of dispersed ownership. In the event that a more widespread move to dispersed equity ownership occurs across Europe, and if high-powered incentive contracts become more acceptable, driven by the internationalization of the market for executives, this approach may the least costly way of diverting problems.

A focus on governance, calibrated in blockholding systems to reflect the role currently played by controlling shareholders, may be the best way to achieve this. Increased shareholder activism and effective disclosure as to structure and process may be the least disruptive pan European approach, particularly as the excesses of the 1990s which drive the executive pay debate generally may be about to be consigned to history as share prices remain depressed and, post Enron *et al*, executive performance remains under the close scrutiny of the financial press. Closer scrutiny of remuneration practices by shareholders can also be expected. Managers may also start negotiating for a greater proportion of their remuneration to be in the

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[115] B. Cheffins, *Company Law: Theory, Structure, and Operation* (OUP, 1997), , 706The point has been well made that executive remuneration is "the most intractable conundrum in global corporate governance": J. Plender "An assault on boardroom excess" Financial Times, March 14 2002, cited in Cheffins (2003) note * , 8.

[116] Yablon (1999) note *, 275

[117] The leading study in support of the rent extraction argument (Bebchuk *et al* (2001) note *) has acknowledged that the potential for rents does not mean that remuneration schemes never serve shareholders' interests .

form of fixed pay, as a bulwark against the poor state of the equity markets.[118] There certainly seems to be some evidence of a move away from US-style option-based remuneration packages in the UK and of a more aggressive focus on performance standards.[119] Even in the US, remuneration committees appear to be exercising restraint.[120] In particular, the dominance of share options may be weakening as companies move towards aligning interests more closely by granting restricted shares, which tie managers more closely to sustained share price performance.[121]

The time may not be right for dramatic intervention given that a shift appears to be underway with respect to executive pay . Further, the complexities of this area, the opacity of the empirical data, and fundamental differences between dispersed and concentrated ownership-based governance systems, caution against any wholesale transplanting of remuneration structures and rationales, empirical evidence, and regulatory responses between the US, the UK, and continental Europe.

[118] See Cheffins (2003) note * , 11. Annual cash bonuses are increasing in the UK: Tassell (2003) note * .
[119] One commentator has noted that huge US-style packages are now so discredited in the wake of Enron, Worldcom, Tyco *et al,* that they can no longer be cited in support of CEO pay in the UK: P. Jenkins, "Wrong package at the wrong time for GSK", Financial Times, Weekend November 30/December 1 2002. in the context of shareholder rejection of the GSK CEO remuneration package.
[120] In February 2003 the Financial Times reported that: "compensation experts, governance activists and unions all agree that the composition of senior executives' remuneration will change this year. Some companies..have already announced cuts in bonuses, stock option awards or perks": A. Hill, "Rations and rewards after a year of turbulence" Financial Times, February 24 2003..
[121] Hill (2003) note * .

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ECGI Working Paper Series in Law

Financial assistance for the services of the editorial assistant of these series is provided by the European Commission through its RTN Programme on Understanding Financial Architecture: Legal and Political Frameworks and Economic Efficiency (Contract no. HPRN-CT-2000-00064).

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