

## Note

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**Concerning:** Public consultation Lippens Code

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### The Executive Remuneration Research Centre

Vlerick Leuven Gent Management School's Executive Remuneration Research Centre was founded in 2006. It performs applied academic research in the field of executive remuneration. Main research topics include performance-related remuneration and performance management, disclosure, and decision-making on executive remuneration. The centre also acts as a content-driven network in which peers discuss and exchange ideas on trends and best practices.

The centre's Prime Foundation Partners are Suez and Dexia Group.

The centre's Foundation Partner is Ter Beke.

The centre's research members are Bekaert, Belgacom, Delhaize Group, Etex Group, GlaxoSmithKline, Total

### Context

The Executive Remuneration Research Centre has conducted an in-depth study of corporate governance charters and annual reports of companies belonging to Bel 20, Bel Mid and Bel Small, with a specific focus on executive remuneration policies and systems. This study has led to the development of a *database on executive remuneration*, which includes (at this moment) data for 2005 and 2006. As from 2006 onwards, the centre also studies company's disclosure practices and the degree to which the Lippens Code is applied. As a consequence, the centre has a good view on how companies deal with disclosure on executive remuneration. Furthermore, the centre conducted a comparative study on disclosure legislation and corporate governance guidelines in Belgium, France, Germany, the Netherlands, and the UK. On the occasion of the centre's meeting on 7 June 2007, a first draft of a raster which could be used for disclosure based on the Lippens Code, was presented. Also, some issues were raised that need further clarification in the Lippens Code.

The aim of this note is to share ideas, put forward opinions, and highlight extracts of the Code Lippens that may need to be further concretised in the light of current business practice. In order to achieve this, a number of suggestions will be formulated. A distinction will be made between more general considerations and concrete issues. The note will follow the structure of the Lippens Code, but it will also take into account the broader framework of the European Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies.

## **The philosophy behind disclosure on executive remuneration**

According to the Executive Remuneration Research Centre's partners and members, disclosure on executive remuneration cannot be avoided. However, there would be a need for a refocus. *The central question is how and what information should be disclosed to the shareholders, being the ultimate target group for disclosure.* The discussion should be brought back to its basics, namely providing the shareholder with important business information. This is about proving that the company has a good policy and a good implementation of it. Other participants in the discussion went a step further by considering disclosure to be a proof of transparency. As such, and in their opinion, disclosure is also about communicating the numbers: 'we have nothing to hide'.

## **Disclosure on executive remuneration in the Lippens Code: general considerations**

In our view, it is not desirable for the Code to move towards an even higher level of detail with regard to disclosure on executive remuneration. However, we think it will have an added value to develop a kind of a *manual or guide* that will help companies with the interpretation of the Code's stipulations. A more detailed description could enhance the application of the recommendations stipulated in the Code and could also make the data more comparable. For example, 'key features of shares, share options', 'the main characteristics of pension schemes', 'main contractual terms', are rather generalist wordings that might need further explanation in order to help companies to provide the relevant information.

Another remark which can be formulated, is that it is not always clear *which information should be disclosed in the CG Charter and which information should be disclosed in the CG Chapter.* A concrete example of this is disclosure on the main contractual terms. Reference 7.18. tells us that 'the company should disclose in the CG Chapter of the annual report the main contractual terms of hiring and termination arrangements with executive managers'. In its turn, reference 7.2 asks for disclosure on the remuneration policy, including the main characteristics of termination arrangements, in the CG Charter. It would be advisable to give a more concrete description on which information on hiring and termination should be disclosed in the CG Chapter, and which information should be disclosed in the CG Charter.

It is also our experience that a number of *companies do not always make a clear distinction regarding where they disclose information on executive remuneration.* For example, some companies disclose information on bonus systems in the annual report, whereas the Lippens Code asks for disclosure on the performance criteria in the remuneration policy (CG Charter). Going further on this topic, disclosure practices with regard to bonuses systems seem to differ a lot. A number of companies limit themselves to general wordings (e.g. bonus is based on corporate as well as individual performance), whereas others, a minority group, communicate concrete measures, weights, minimum, target, etc. A remark that could also be made in this respect, is that the Lippens Code goes deeper for disclosure on variable pay (concrete performance criteria) than for the other remuneration elements.

**Disclosure on executive remuneration in the Corporate Governance Charter:  
specific considerations and suggestions**

Reference	Considerations & suggestions
7.2.	<p>It is mentioned that the CG Charter should include the remuneration policy. However, ‘remuneration policy’ is not further explained in reference 7.2. On the other hand, in Appendix E, reference 5.4./4., it is mentioned what the remuneration policy should include.</p> <hr/> <p><u>Suggestion:</u> Make a reference to 5.4./4 in 7.2</p>
7.2.	<p>The European Commission Guideline also asks for disclosure on any significant changes in the company’s remuneration policy as compared to the previous financial year. This is information which is very relevant to the shareholders.</p> <hr/> <p><u>Suggestion:</u> Change 7.2. into: ‘In the CG Charter, the company should disclose its remuneration policy and any significant changes in the remuneration policy compared to the previous financial year’.</p>
7.18.	<p>It is mentioned that the remuneration policy should be disclosed in the CG Charter. Even though it is very relevant for the shareholder to be informed about the decision-making process, this is not in the Code’s stipulations. Moreover, the European Commission Guideline asks to disclose information concerning the preparatory and decision-making process used for determining the remuneration policy (3.5.).</p> <hr/> <p><u>Suggestion:</u> Companies should be asked to develop a raster with an inventory of who is responsible for which decisions on executive remuneration. Also information should be added on who decides upon remuneration issues for other managerial and operational employees.</p>

**Disclosure on executive remuneration in the Corporate Governance Chapter of the Annual Report: specific considerations and suggestions**

Reference	Considerations & suggestions
<p>7.15. 7.16. 7.17.</p>	<p>Distinction between basic remuneration, variable remuneration and share-based remuneration. It is possible that variable remuneration is share-based (e.g. bonus deferral, performance shares). As a consequence, it is not clear whether these kinds of remuneration should be included in variable remuneration or share-based remuneration (or both).</p> <hr/> <p><u>Suggestion:</u> Change the remuneration instruments into basic remuneration, bonus payment in cash, bonus payment in share(s) (options), annual bonus-pension plan, other share-based remuneration (not linked to annual bonus).</p>
<p>7.15. 7.16.</p>	<p>‘Amount of the remuneration’: it is not made explicit what this is about, total cost or gross salary. This is also related to whether the executive is employed as an independent (or a firm) or as an employee. Experience has learnt that a number of companies mention ‘gross amount’ while the number was about ‘total cost’. Discussion also revealed that a comparison between different executive board members in a global organisation is very difficult on the basis of total cost. Gross remuneration seems to be the most important measure.</p> <hr/> <p><u>Suggestion:</u> Companies should be asked to provide a clarification whether the amount of basic and variable remuneration is on a total cost basis or gross remuneration. They should also be informed about what total cost and gross remuneration exactly mean. The best might be to ask companies also to disclose the statute of the CEO and other executives. This information could also be disclosed in a footnote.</p>
<p>7.17.</p>	<p>‘The number and key features of shares, share options or any other rights to acquire shares, granted during the year’:</p> <ul style="list-style-type: none"> <li>▪ It should be clarified what form of share-based remuneration is in place, e.g. stock options, free shares, restricted stock, performance shares.</li> <li>▪ It should be clarified more what ‘key features’ exactly means. For example: exercise price, term, vesting, lock-up.</li> </ul> <hr/> <p><u>Suggestion:</u></p> <ul style="list-style-type: none"> <li>▪ Ask for the type of share-based remuneration.</li> <li>▪ If applicable (depending on the instrument), ask for term, vesting, exercise price.</li> </ul>

Reference	Considerations & suggestions
7.17.	<p>Concerning share-based remuneration, only the grants during the year have to be disclosed according to the Lippens Code. This is not in line with the European Guideline, which also asks for disclosure on exercises during the year and stock (option) holdings. To be in line with the European Guideline, the following information should be disclosed with regard to share-based remuneration: holdings at the beginning of the financial year – grants during the financial year – holdings at the end of the financial year.</p> <hr/> <p><u>Suggestion</u>: ask for disclosure of a table, providing the following information:</p> <ul style="list-style-type: none"> <li>▪ For stock options: balance at beginning of financial year, grant during current financial year, exercise price, exercised during current financial year, forfeited, expired, balance at end of financial year</li> <li>▪ For restricted stock and/or performance shares: number of shares at beginning of financial year, grant during current financial year, exercised during current financial year, forfeited, expired, balance at end of financial year</li> </ul>
7.17.	<p>Although this is not mentioned in the Lippens Code, it can be important/interesting to tune the information that is disclosed on the CBFA website to the information disclosed in the annual report.</p>

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