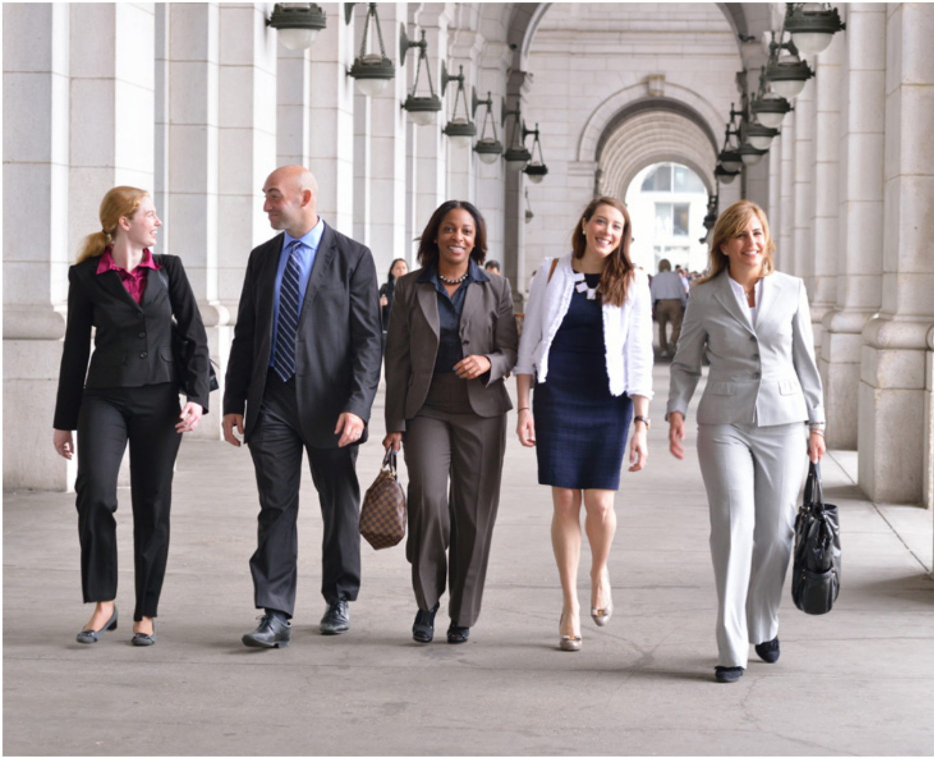
English version

Remuneration

Why is sound remuneration policy so complex?

October 2016



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Introduction

Remuneration is a multi-faceted issue

The remuneration offered to executives continues to be a sensitive topic. This is definitely the case for variable remuneration in today's climate, where stakeholders inside and outside the company keep a close eye on the supervisory board and do not hesitate to make a fuss in public. Good performance should be accompanied by suitable remuneration, but failure should not be rewarded ('pay for performance, no reward for failure'). Companies risk having their remuneration proposals rejected by the meeting of shareholders if salary increases for managers are accompanied by worsening company performance and/or shareholder returns, and if the supervisory board is unable to justify increases in remuneration within the encountered context.

Remuneration is a 'multi-faceted issue', which requires supervisory directors to respond with the necessary leadership, professionalism, experience, wisdom and determination. The supervisory board is not automatically 'in control' once the remuneration policy has been confirmed by shareholders. Problems can be encountered if the board has insufficient insight into, and control over, the often conflicting interests of stakeholders – the so-called 'remuneration arena'.

Approval from society is a major issue

The context in which supervisory boards make decisions about remuneration appears to be becoming increasingly complex because everything is being scrutinised by the board, politicians, media and wider society. In addition, laws and regulations have also become a lot stricter. Companies are almost being overloaded by a surge in remuneration-related legislation.

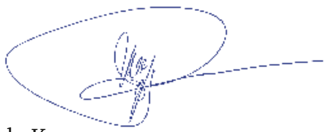
The issue can no longer be simply addressed by supervisory directors, directors and shareholders in the remuneration arena. Approval from society is a major issue when dealing with the interests of stakeholders. If the supervisory board fails to address the interests of this wide range of stakeholders, this could reduce confidence in the company and lead to reputation and image-related damage.

Remuneration policy does not only focus on directors

Of the three roles fulfilled by the supervisory board – supervisor, sounding board and employer, the role of employer can sometimes be overlooked. This booklet addresses the subject of 'Remuneration' and not the whole domain of the Management Board Employment Committee – this title is more appropriate than the term 'remuneration committee' mentioned in the Dutch corporate governance code. However, the topic must be examined within the broader role of the employer.[1]

In addition, new supervisory requirements mean the supervisory board should not only restrict itself to directors when dealing with the issue of remuneration. The board must pay equal attention to creating a balance within internal remuneration policy, for example, a balance between top and middle management and a balance between the CEO and the average (or lowest paid) employee. The same applies to remuneration in shares and options. The supervisory board must have a comprehensive insight into all outstanding shares and options so it can determine to what extent shares will be diluted. Furthermore, the supervisory board should attempt to be 'in control' of variable remuneration awarded to top managers, which could pose a significant risk.

This booklet uses the latest topics to offer practical tips about how to effectively address and discuss the multi-faceted issue of remuneration.



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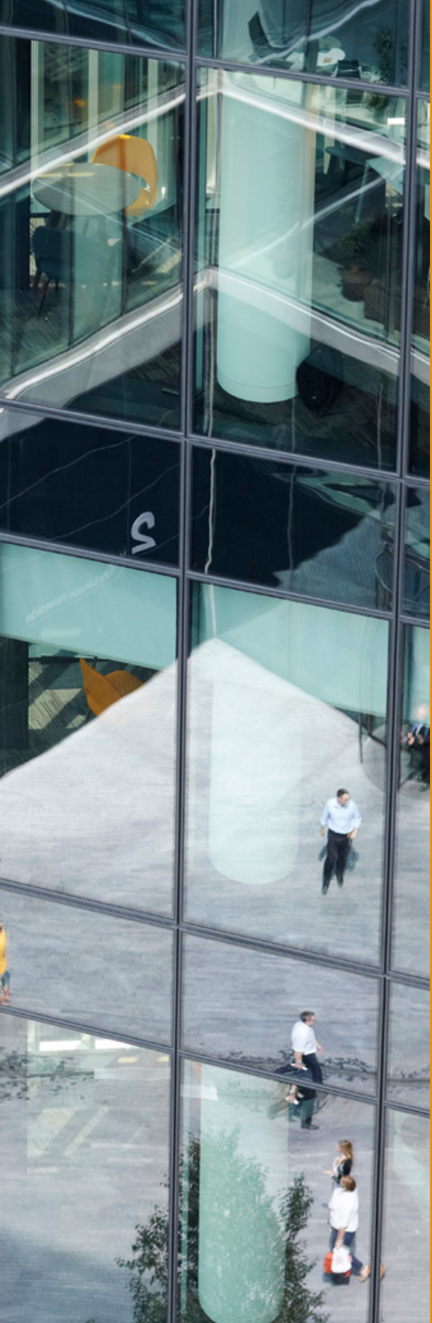
1 For the broader role of the employer – e.g. leadership, executive development, succession planning, assessment and performance, please refer to the Employment practices chapter in the National Registry's Commission Toolkit entitled 'Insight is more useful than supervision' (October 2013).



An evaluation framework is useful

Issues that take place in such a complicated context must be considered carefully, and a self-developed evaluation framework could be useful when trying to realise coherent and responsible remuneration policy.

This kind of framework for assessing remuneration-related decisions must at least consider the following areas/factors:

- the company's vision, mission, ambition and core values ('DNA');
- business model (earnings model) and strategic objectives;
- main performance indicators (KPI's);
- main risk indicators and risk appetite;
- the company's overall human resources policy;
- competitiveness and sustainability of the remuneration framework;
- financial impact of variable remuneration;
- leadership development and talent management;
- performance management: target setting, monitoring, measurement, assessment and remuneration;
- governance of remuneration (processes, procedures, policies);
- stakeholder engagement, dialogue and communication; and
- openness and accountability about remuneration policy within the remuneration report and/or during the meeting of shareholders.

Why is sound remuneration policy so complex?

1. ***Link to strategy and risk***
   Strategy, results, risks and leadership are strongly related. The whole organisation's remuneration policy must be consistent with the nature of the company, its strategic objectives, risk profile and its human resources policy. Although statutory directors have a separate legal status, it is important to base decisions about director remuneration on a robust, company-wide remuneration framework.

2. ***Many stakeholders, conflicting interests***
   The issue of remuneration is rather complicated: there are many stakeholders and interests, and the supervisory board must consider various perspectives. The main dilemma involves having to offer top executives a competitive remuneration package, while considering political and societal pressure to cut back on top salaries. This leads to an extremely difficult dilemma, which requires the supervisory board to perform a 'balancing act'.

3. ***Reputation damage if companies 'reward failure'***
   Shareholders and other stakeholders tend to accept high remuneration if it is accompanied by excellent performance; but they don't like to see directors being rewarded for sub-standard performance or failure. It is difficult to justify paying 'at target' bonuses when companies perform poorly or paying golden handshakes to directors who have not done their job properly. People can quickly lose trust due to the press and social media; that is why extra attention must be given to remuneration when dealing with reputation-related risks and corporate communication.

4. ***Complexity***
   The complexity of laws and regulations, corporate governance codes and internal remuneration policy, and the complexity of the issue of remuneration in its own right, mean a considerable amount of time, attention and money must be invested in order to effectively manage remuneration (also see 'In Control' below).

5. ***Remuneration as risk***

Structures used for variable remuneration could provide extra risks, particularly when it comes to ambitious 'all or nothing' performance objectives, which could encourage employees to take extreme risks or display inappropriate behaviour just to achieve bonus targets. There is actually nothing wrong with ambitious performance objectives per se. However, they must be closely monitored by controllers (risk management, compliance and eventually internal control) to ensure an appropriate balance between performance and risks.

6. ***Governance: processes, procedures, policies***

The remuneration of directors and key figures within organisations is not a separate process, but is actually embedded into the annual performance management cycle (planning, monitoring, measurement and evaluation). At the start of each year, the supervisory board must use remuneration policy to identify performance objectives (type of targets and level of targets). Actual results must be measured at the end of the year and compared against the agreed targets. This annual cycle requires a robust system for processes, procedures and (the implementation of) policies. Director remuneration governance is even more complicated because remuneration policy must be confirmed by the meeting of shareholders, which means many stakeholders are involved.

7. ***Transparency, accountability and communication***

The supervisory board as has wide discretionary authority to reasonably and fairly determine or modify final remuneration within established remuneration frameworks. Transparency, accountability and effective communication about how this discretionary authority is used will determine the extent to which such decisions are accepted. The supervisory board must be able to clearly explain why, for example, a director is awarded variable remuneration even though results have been disappointing.

The various interests when it comes to remuneration

One of the reasons why the issue of remuneration is so complex is because supervisory directors and regulators need to consider so many interests and perspectives. Who are these stakeholders? What are their perspectives? What do they involve? What is their impact? Who determines what? The following overview offers a better insight into this complex issue.

Shareholders (AGM)

Task	- Determine remuneration policy for board of directors at stock market-listed companies (and non-stock-market-listed private companies). - Approve remuneration arrangements for board of directors, in the form of rights to shares.
Authority	Article 2:135 sections 1, 4 and 5 CC
Interest	- Appropriate remuneration which, in terms of amount and structure, can attract high quality directors. - Equal focus on the interests of shareholders and directors. - Long-term value creation for the company. - Attractive overall return on shares (in absolute and relative terms).
Influence	Proposed remuneration policy is rarely rejected; but proposals are often withdrawn by the supervisory board prior to the meeting of shareholders (AGM). Heavy criticism of proposals can lead to a lot of 'no' votes (30-40%), and the accompanying media attention.

Remuneration committee

Task	- Develop proposals for new or modified remuneration policy for the board of directors. - Perform scenario analyses for variable remuneration. - Make proposals for individual remuneration within remuneration policy (target-setting in advance, performance measurement afterwards).
Authority	The remuneration committee is a core committee of the supervisory board and has no formal decision-making authority – see below under supervisory board.
Interest	Appropriate preparation and implementation requires regular and intensive interaction with internal stakeholders (directors, Human Resources (HR), Finance, control functions) and external stakeholders (remuneration consultants, representatives of shareholders and institutional investors, recruitment and selection agencies).
Influence	Excellent preparation plays a very important role and helps to prevent surprises for the president non-executive director during the AGM.

Supervisory Board

Task	- Attract qualified and experienced directors from the (external and internal) market. - Make decisions about proposals for new/modified remuneration policy for the board of directors, while considering (i) scenario analyses; (ii) the impact of the decision on the internal pay ratios; (iii) internal and external advice from experts; and (iv) informal dialogue (‘sounding’) with organisations that represent institutional investors (Eumedion, ISS, VEB) about the feasibility of the remuneration proposal presented to the AGM. - Determine individual remuneration of directors within remuneration policy (target-setting in advance, performance measurement afterwards). - Plan the follow-up of directors (succession planning).
Authority	- Article 2:135 section 4 CC, together with company statutes where the supervisory board has been appointed as qualified body. - Best practice stipulation II.2.1 to II.2.3 of the Dutch corporate governance code (2008).
Interest	Major. The supervisory board owns the remuneration dossier and must consider the interests of all direct stakeholders (directors, shareholders) during its deliberations and decision-making, as well as other stakeholders who must be appropriately informed in good time.
Influence	Major.

Management Board	**Task**	- Manage the company: the management board is responsible for realising strategic objectives within the risk profile, the development of results and corporate social responsibility. - Attract, motivate and retain senior management, key officials and talented employees (high performers, high potentials), e.g. via competitive remuneration packages. - Appropriate, balanced and 'fair' remuneration for directors: appropriate remuneration balance within the board of directors as well as the second tier of positions that report directly to the board of directors (in other words: with executive management), and in relation to the highest paid employees in the CLA). - Manage risks associated with remuneration, including reputation-related risks for the company.
	Authority	Article 2:129 BW Principles II.1 and II.2 Dutch corporate governance code.
	Interest	Strong interest in appropriate remuneration policy, suitable implementation of remuneration policy and being 'in control' of internal remuneration governance within the organisation.
	Influence	Significant

Individual directors	**Task**	Appropriate and 'fair' remuneration for own position in terms of fixed and variable income (opportunity) and other contractual conditions; 'fair' in relation to a suitable external benchmark and internal norms, and remuneration that matches the realised performance/results ('pay for performance').
	Authority	Principle II.2 Dutch corporate governance code. Best practice stipulation II.2.1 to II.2.3 of the Dutch corporate governance code (2008).
	Interest	Strong interest in appropriate individual remuneration packages, which is perceived as 'fair' by concerned directors.

Work council (WC)/ employees	**Task**	- Determine a standpoint about proposals for new or modified remuneration policy for board of directors before the AGM is called and, if necessary, explain the standpoint at the AGM where the proposal is presented for confirmation. - Request information about legal status of arrangements for various groups within the organisation, the remuneration balance within these groups and the changes per group (for example, suitability of salary increases).
	Authority	Article 2:135 section 4 CC. Article 31d Works Councils Act.
	Interest	WC's right to speak is not seen as a major authority; however, the view of the WC is presented to shareholders as an appendix accompanying the scheduled issues.
	Influence	Moderate.

Organisations that represent shareholders and institutional investors, proxy voting agencies, corporate governance rating agencies	**Task**	- Represent interests of affiliated shareholders, often major international institutional investors, but also private investors (Eumedion, ISS, GlassLewis, ABI, VEB). - Publish principles for responsible remuneration policy and/or guidelines for issuing voting advice in remuneration-related issues scheduled in the MoS. - Be available for an informal discussion about proposals for changes to remuneration policy or proposals for a new remuneration policy.
	Authority	'Sounding' about remuneration proposals based on common market practice, not based on formal authority.
	Interest	Evaluating feasibility of remuneration proposals in the MoS. Modification of proposals if opportune.
	Influence	Negative voting advice can lead to remuneration proposals being rejected and negative press coverage.

Politicians, (social) media, wider society	**Task**	- Hold discussions about the need to generally reduce top salaries. - Critically analyse and reflect about excessive top salaries, perverse incentives in bonus structure, undesired behaviour, etc.

CEO pay ratio says nothing about fair remuneration[2]

The question of ' what is fair or appropriate remuneration?' cannot be addressed by simply implementing a fixed ratio between the salary paid to the CEO and the average salaries paid within the organisation.

In late 2013, the American Securities and Exchange Commission (SEC) published a proposal featuring a set of rules for the 'CEO pay ratio'. These rules require major American companies to publish the ratio - of overall CEO remuneration compared to the average total remuneration for all other employees - in their annual reports.

In November 2013, the Swiss public were given the opportunity to vote in a referendum about a proposal submitted by the junior Socialist Party, which stipulated that company directors could not earn more than twelve times the salary of the lowest paid employees.

This proposal was rejected by the Swiss public, but the referendum illustrated the commotion in society caused by irresponsibly high salaries for top managers.

The question of 'what is an appropriate, fair and responsible remuneration for directors of large international companies?' cannot be simply addressed by implementing a CEO pay ratio. Using a single benchmark to determine director remuneration is not the best or most stable way of realising fair remuneration.

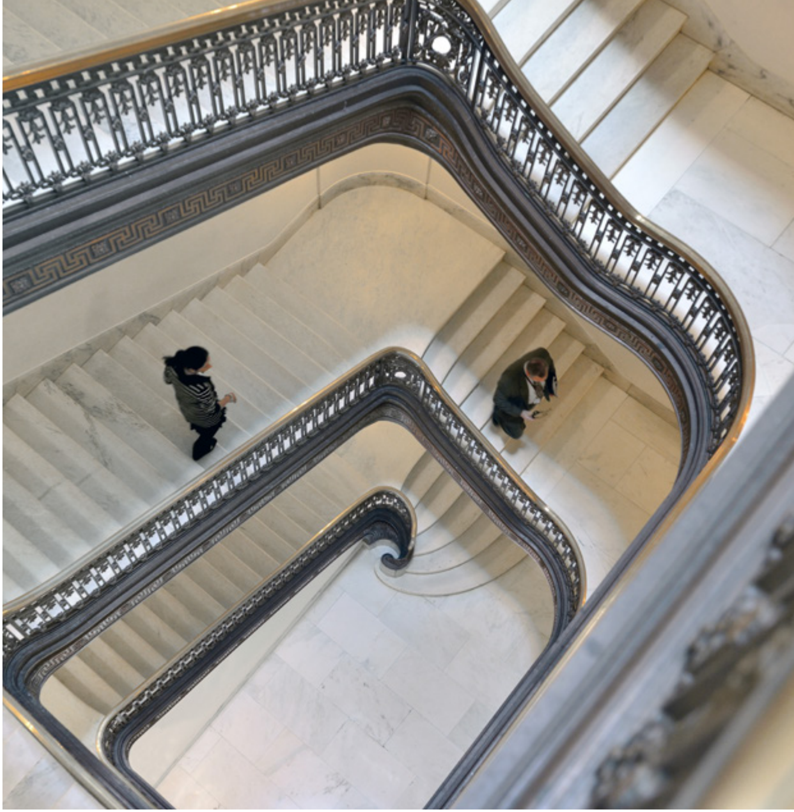
Naming and shaming

Politicians and the general public tend to use the ratio for 'naming and shaming'. In the USA, there are various rankings for American companies and their CEO pay ratios. But shareholders don't really appear to be interested.

Their main concern is the relationship between director remuneration and financial results, often compared to similar companies - thus 'pay for

2 This a revised version of the article that Paula Kager and Gijs van Bussel (PwC Partner and professor at Nyenrode Business University) published in Governance Update in October 2013.

performance'. If directors score well on this front, they have no issues with them being paid well. To determine what is fair, directors themselves also check what other similar companies are paying. If the market pays a particular amount for fixed and variable salary, it would be unrealistic to pay below this level. So it is not wise to abolish variable remuneration; this would mean that organisations can never attract the top executives they need.



The idea that bonuses are ineffective has not been scientifically proven. Focus is created by setting performance targets and offering appropriate rewards. This has been proven by more than enough studies.

No solid foundation

Using a single objective to determine director remuneration is not the best or most stable way of realising fair remuneration. Within the Netherlands' 'governance and remuneration arena', supervisory boards have to use their own norms and core values to weigh up the interests of all involved stakeholders. The SB can be assisted in this assessment by formulating remuneration norms for acceptable remuneration ratios, 'pay for performance', sustainable value creation and public support. However, this requires due care, a tailor-made approach and effective accountability.

Accountability in the remuneration report[3]

The supervisory board faces a difficult dilemma when it comes to accountability for implemented remuneration policy. How open and transparent does the board have to and want to be in the current 'remuneration arena'?

Have to	Explanation annual accounts: article 2:383 c to e CC; Remuneration report: Principle II.2 and best practice stipulations II.2.10 to II.2.15.
Want to	Openness and accountability about determining variable remuneration, golden handshakes, one-off payments outside standard policy and internal remuneration ratios. Communicate own remuneration norms. Emphasise link between performance and remuneration. Create public support.
Be able to	Many stakeholders, many interests. Major risk to reputation. Supervisory boards that do not, or do not punctually, anticipate external criticism are left fully exposed and sometimes need to get on their hands and knees to limit the damage.

Code: promoter or inhibitor?

The annual reports of Dutch listed companies did not feature remuneration reports in the years prior to 2004. In fact, director remuneration was only explained in one set of annual accounts. As of 2004, remuneration reports were compiled in accordance with the Dutch corporate governance code. The code features an overview of information that must be featured in the remuneration report - a list from letter a) to j) - but no guidelines about the format, structure, content, level of specification and good practices. This did not appear to be necessary. Self-regulation actually worked well: the quality, specificity and informative value of current reports is in no way comparable with those prior to 2004.[4] The code has now become an inhibitor rather than a promoter. In terms of ambitions, it can cause companies to simply stick to the minimum prescribed level.

3 From: article entitled 'Performance-based remuneration' and the Remuneration report, Spotlight 2012-4 (December 2012) by Paula Kager and Frank van Oirschot, Executive Reward, Tax & Human Resource Services.

4 For suitable examples, please refer to remuneration reports in the annual reports of DSM, Shell, Akzo Nobel and Philips.

SB's that do not, or do not punctually, anticipate external criticism are left fully exposed and sometimes need to get on their hands and knees to limit the damage.

Remuneration reports that are given a score of ±6, often feature standard wording which has literally been copied from the code.

Context for accountability is a lot more complicated in 2014

Remuneration for directors continues to be a very sensitive issue. Stakeholders expect people to be accountable to society. They also expect the SB to have a firm grip on director remuneration - for SB's to be 'in control' - and be able to communicate effectively about dilemmas and difficult issues. SB's that do not, or do not punctually, anticipate external criticism are left fully exposed and sometimes need to get on their hands and knees to limit the damage.
Eumedion expects remuneration committees to present draft proposals for changing remuneration policy, so they can be discussed informally; this has been standard practice in the United Kingdom for many years.

This also applies to international voting advice agencies such as Institutional Shareholder Services (ISS) / RiskMetrics. Such agencies can advise people to reject proposals if they conflict with policy guidelines they implement.

Transparency and accountability about performance-based remuneration

Good remuneration reports do not only feature specific information about performance criteria for variable remuneration and their link to strategic KPI's (ex ante), but also an explanation about actually earned variable remuneration: including bonuses in cash and unconditional shares and options (ex post). Scores achieved for these performance criteria determine how much variable salary is actually earned.
If the company fails to fully meet its strategic KPI's, the SB is entitled to reduce remuneration or explain why the principle of 'a promise is a promise' is still implemented.

Variable remuneration: keep or abolish?

Organisations in the (semi-) public sector are, as of 1 January 2013, subject to the 'Act for the standardisation of publicly and semi-publicly financed remuneration of top managers', which is also referred to as the Salary Standardisation Act (WNT). The WNT has prohibited variable remuneration. Directors of financial institutions that have received government assistant are also prohibited from receiving variable remuneration so long as government assistance is ongoing. As of 2015, variable remuneration in the financial sector will most likely be restricted to 20% of the fixed salary. Here are the main arguments for and against variable remuneration.

Abolish

- It is aimed at managing behaviour, but the results of variable remuneration are often a surprise – thus does not work as a behaviour management tool.
- It also aims to motivate; high bonuses only have a short-term effect, while dissatisfaction about disappointing bonuses stays for a long time.
- Performance targets often feature perverse incentives and can lead to risky behaviour.
- Variable remuneration systems have become way too complicated: no one understands how they work any more.

Examples of poor remuneration policy (remuneration not based on performance, and rewards for failure) are clear for all to see.

- The cost of top directors is no longer proportionate to the value they generate; the remuneration spiral continues to sky rocket.
- Intrinsic motivation in directors and other managers is more important than a remuneration package featuring variable remuneration.
- Companies can profile and distinguish themselves by abolishing variable remuneration.

Keep

- Variable remuneration offers companies flexibility in matching remuneration with results; it is thus a cost-efficient instrument.
- Performance-based remuneration works if it is well embedded into the performance management cycle (planning, monitoring, measurement and evaluation) and if up-to-date information is punctually available about KPI's.
- Variable remuneration enables the supervisory board and/or management to focus on strategic objectives.
- Variable remuneration, via shares that must be kept for a long period of time, helps to bring the interests of employees and shareholders in line with each other.
- In the private sector, variable remuneration is a standard part of the overall remuneration package used by companies to compete for top talent in the market.
- The aim of variable remuneration: motivate, commit and reward. This works in practice.
- There are many types of variable remuneration and benefits; for instance, financial participations (share purchase plans, co-investment management in private equity settings, etc.).

Increase in non-financial KPI's for variable remuneration

Non-financial performance criteria started to become popular in 2008; the year in which the updated code was presented by the Frijns committee. The code stipulates that, when determining the level and structure of director remuneration, the SB must take into account the evolution in results, the share price, non-financial indicators and risks that variable remuneration could pose to the company. This relates to non-financial indicators that are relevant to the company's value creation possibilities in the long-term.

The use of non-financial performance criteria has increased significantly in recent years. These days, AEX companies use a mix of financial and non-financial criteria, where the balance between financial/ non-financial is shifting towards non-financial criteria. But financial criteria are still dominant.

Wide range of non-financial performance criteria

A lot of non-financial indicators are available. The following structure offers a bit of guidance:

Category	Objectives
Customers	Customer satisfaction, Net Promotor Score.
Employees	Employee engagement, personnel & organisation statistics.
Environment	Energy consumption, CO_2 emissions, health and safety.
Company	Progress in strategic agenda, operational effectiveness, product introduction/ project completion, risk management and compliance, innovation, reputation/ brand value, corporate social responsibility (CSR).

Critical attitude towards non-financial performance criteria

The Association of Investors for Sustainable Development (VBDO) promotes the introduction of social, environmental and sustainability-related objectives into the variable remuneration offered top directors, and clearly and vociferously express this at shareholder meetings. We believe companies must critically examine the use of non-financial performance criteria, for the following reasons:

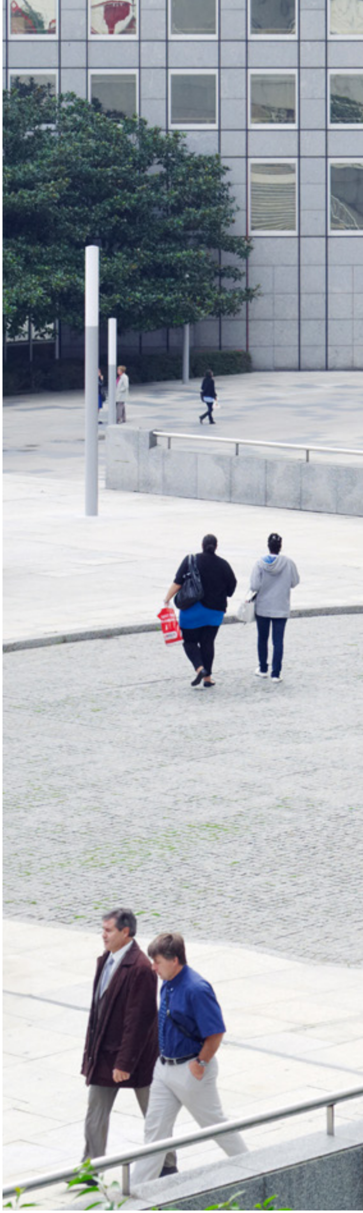
- **Superficial coating**
  Motivation and justification are not always clear. Is it really part of the core values, mission and strategy (the company DNA) or is it just a superficial, trendy gimmick aimed at improving reputation? Don't stakeholders give management a 'license to operate' anyway? Do companies want to establish this in the performance objectives for variable remuneration?

- **Loss of focus**
  The overall number of performance objectives can quickly rise to more than 10. What should the SB then focus on?

- **Measurability and relevance for strategy**
  That which applies to financial targets (specific, measurable, acceptable, realistic and time-bound, SMART), also applies to non-financial targets. That is why Eumedion has established conditions for the use of sustainability benchmarks.[5]

Jackpot every time

If you do not achieve financial key performance indicators (KPI's), then non-financial KPI's offer you the ideal back-up plan so long as the criteria are not specific and measurable. With this in mind, the SB could make non-financial scores subject to certain financial targets being met, e.g. a threshold value. It would be wise to make procedural arrangements about this in advance.



5 Principles for responsible remuneration policy, Eumedion, December 2013.

Remuneration is risk management[6]

Recent events have once again demonstrated that bonuses can be ‘perverse’ incentives that encourage employees to display unwanted behaviour, like fraud. A lot has already been written and said about why top traders in major financial centres partake in fraudulent activities. Their business culture and remuneration structure no doubt play an important role in this. They can earn a lot of money for the bank where they work and thus make a difference – and they know that all too well. Their variable remuneration can be several times higher (2 or 3 times) than their fixed remuneration. Money is a major incentive in their minds. If this remuneration structure is accompanied by increased risk of excessive behaviour, then companies have to implement stricter checks to manage the accompanying risks.

A remuneration structure can feature incentives that encourage employees to display behaviour not featured in the risk strategy (c.q. the risk profile). Clear examples of such remuneration incentives include:

- salespeople with a low fixed salary and a potentially high variable income, particularly if the fixed salary is not enough to make ends meet;
- high bonuses linked to very ambitious performance objectives (targets);
- bonuses linked to an ‘all or nothing’ performance objective (0 or 1, no interim scores);
- bonuses only linked to short-term results (quarterly, 6-monthly or annually);
- bonuses only linked to financial and/or quantitative targets, in other words: variable remuneration based on a formula of measurable indicators (the ‘what’ part) without taking behaviour into account how results have been achieved (the ‘how’ part);
- variable remuneration that only leads to a bonus and not to a penalty.

In the financial sector, these remuneration incentives were more or less standard practice prior to the credit crisis.
Since 1 January 2011, financial institutions have been subject to the

6 Revised article from November 2013, by Paula Kager in Governance Update.

Arrangement for Controlled Remuneration Policy (Wft) 2011, and monitoring of remuneration has been intensified by DNB and AFM. An important feature in this arrangement is the involvement of control functions in the creation and implementation of remuneration policy. But the arrangement can also be implemented by companies from other sectors. Remuneration and risk are closely related in several ways. How can companies manage the risks associated with remuneration? Here are 10 practical tips:

1. Make sure fixed salary is high enough to cover the costs of everyday living.
2. Create an appropriate balance between fixed and variable income; financial institutions have committed themselves to a maximum ratio of 1:1 (Banking Code).
3. Make sure formulated objectives are SMART, with interim scores possible.
4. Create a balanced set of diverse performance criteria, e.g. via a balanced scorecard (focus on 'what' and 'how').
5. Ensure a good mix between short and long-term objectives.
6. Include remuneration-related risks in the company's periodic risk analysis.
7. Make sure the Compliance and Risk Management department is extra vigilant – implement extra 'controls' – if there is heightened risk of inappropriate behaviour.
8. Make such extra checks are also part of the internal auditor's control.
9. Ensure robust processes and procedures when making decisions about variable remuneration.
10. Make sure the remuneration committee gains and maintains an insight into the involvement of control functions in the remuneration dossier (policy forming and implementation).

Of course, a lot more than these 10 practical tips is needed to prevent fraud. However, a good way to get started is to be 'in control' of the potential side-effects of bonuses, particularly if the company is very ambitious and expects good results. Remuneration-related governance is not merely a task for the upper echelons of the company, but also for the rest of the organisation.

The ‘red flags’ for shareholders

Council of Institutional Investors (CII) (2010):
The Council of Institutional Investors (‘the voice of corporate governance’) represents the interests of pension funds and other institutional investors. In 2010, the CII published a top-10 of red flags for shareholders when voting about remuneration proposals. This list is still valid today:

1 Policy about long-term shareholding: do top executives only have minor shareholdings and can they sell their shares immediately before they depart?

2 Claw back of variable remuneration: does the company have a policy for recapturing bonuses which later appear to have been paid unjustifiably, because they were based on inaccurate information (‘claw-back’)?

3 Performance drivers: is only a small part of overall remuneration subject to performance objectives? Is the annual bonus linked to a performance target and does this also apply to long-term variable remuneration? Does the company report about controls, procedures and risk management in relation to top salaries?

4 Extra benefits (‘with bells on’): do directors enjoy excessive benefits that cannot be professionally justified?

5 Internal remuneration ratios: is there a major difference between the remuneration of directors and the remuneration of sub-management (people who report to the SB)?

6 Share options: are unconditional share options provided, which can be claimed like a ‘free lunch’ or ‘free lottery’, or is the uptake limit for options modified if requirements are not met?
Performance targets: are performance targets ambitious enough and does the remuneration report feature enough information about the type and weighting of performance criteria?

7 Performance targets: are performance targets ambitious enough and does the remuneration report feature enough information about the type and weighting of performance criteria?

8 Golden handshakes: can golden handshakes be seen as ‘rewards for failure’? Are buy-out arrangements during mergers or takeovers so attractive that directors could be tempted to sell the company even though this is not in the interest of shareholders? Do directors retain rights to extra benefits once they have departed?

9 Transparency and accountability about implemented remuneration policy: is remuneration policy vague, confusing, incomplete, fully focussed on ‘what’ and ‘how’ while ‘why’ is missing, and so complicated that you can’t see the wood for the trees? Do reports fail to address the relationship between remuneration and performance? Does the list of peer companies raise eyebrows?

10 Independence of the remuneration committee: does the remuneration committee have the same remuneration advisor as the management?

Glass Lewis & Co. (2013):

Glass Lewis & Co. is involved in governance-analyse and provides voting advice to institutional investors. Glass Lewis does not use a check-list with automatic triggers for objectionable remuneration practices, but evaluates each remuneration proposal on its own merits.

However, they do use a list of potential remuneration issues which, together with other problematic aspects, could lead to negative voting advice:

- Inappropriate group of comparable companies for benchmarking (peer group);
- Inadequately or insufficiently substantiated change in peer group;
- Outrageous or excessive bonuses, issue of shares, severance arrangements, including golden handshakes and golden welcome bonuses (signing-on money);
- Guaranteed bonuses;
- Total remuneration package above average for the market, without appropriate justification;
- Variable remuneration (short/long-term) targets are set lower than the average performance levels;
- Performance objectives not ambitious enough (targets) or high variable remuneration for mediocre performance;
- Reduction in performance objectives without substantiation;
- Pay-out of discretionary bonuses if regular short and long-term variable remuneration arrangements do not lead to pay-out;
- Relatively high remuneration for top executives compared to peers, not justified by the company’s performance.

10 'detection tips' for unwanted practices

#	Demand	Explanation
1.	If performance over the past year was mediocre or poor, is this also reflected in the annual bonuses of directors?	One can expect amounts paid for annual bonuses to be strongly linked to improved or worsened performance. If bonuses do not decrease for disappointing performance, one should question what is being measured and how this is done.
2.	Is remuneration offered to the CEO/chairman of the board more than 2 or 3 times higher than the average remuneration awarded to other directors?	The size of the gap in remuneration, between the chairman of the board and the other directors, can lead to problems in succession planning and moral. CEO's are not superstars, but simply team leaders; and they should be paid accordingly. Tone at the top!
3.	Is short-term variable remuneration based on a single performance criterion, and does the same criterion apply to long-term variable remuneration?	A mix of performance criteria is normally more compatible with strategy than a single criterion (which can lead to manipulation; 'gaming'). If the same criterion is used for short and long-term incentives, it means people are rewarded twice for the same performance.
4.	Are various incentive arrangements being stacked (in cash and/or shares)?	If various incentive arrangements are stacked, this causes remuneration to become unnecessarily complicated (a 'black box'). There is a risk of the system always leading to pay-out, even if this is not justified by the performance.
5.	Are the yields realised by directors when cashing in on their options and shares in line with the long-term performance of the company?	Exploiting increases in the share price for free can be prevented by making sure share incentives are determined by performance targets, blocking the shares for a few years and by introducing a shareholding requirement.
6.	Does the long-term share incentive arrangement lead to pay-out if the company performs below average in the peer group?	Many long-term share arrangements have 'relative TSR' (total share returns, in other words, value increase plus dividend yield). If shares partly become unconditional ('vesting') if the company ends in the lower half of the peer group over a 3-year period, this can be seen as a sign of overly generous targets.
7.	Are directors being awarded overly generous pensions? Is the mutation in the pension provision higher than in all other remuneration components combined?	Director pensions that are based on the final salary can turn out to be very expensive; pensions based on available premium are a lot more common in the market. If pension costs are higher than the cost of total remuneration excluding pension, then this should be seen as a red flag.

8.	Does the supervisory board use its discretionary authority in situations where regular variable remuneration arrangements do not lead to pay-out?	This is referred to as the ‘always a winner’ phenomenon. If directors do not perform effectively in financial objectives, then they can always make up for this with 'soft' qualitative objectives.
9.	Do buy-out arrangements lead to conflicts of interest during mergers or takeovers (‘change of control’ stipulation)? Is there a ‘single trigger’?	Most share incentive arrangements lead to a ‘change of control’ (takeover, merger, demerger), whereby outstanding (conditional) shares can become unconditional a lot sooner. This can lead to major buy-out payments, certainly if only a single trigger is needed to activate the clause. A conflict of interests could be encountered if people have major personal financial interests during e.g. takeovers.
10.	Are excessively high amounts awarded for other allowances?	'Other allowances' include all the usual employee benefits: telephone, computer, car, professional insurance, etc., but also ‘perks’ – costs for double accommodation, financial advice, club memberships, personal security, grossing of taxation on salaries in kind, etc. Excessive amounts could point to a SB that has difficulties saying 'no' to demanding directors.

Pitfalls and remedies in 'governance and remuneration arena'

As mentioned earlier, remuneration is a multi-faceted issue, which requires appropriate leadership, professionalism, experience, wisdom and determination from supervisory directors to personally take control. There is a real chance of slip-ups and major accidents. The main pitfalls and areas of attention for supervisory directors are:

#	Pitfall	Remedy
1.	Absence of own reference framework for remuneration.	Formulate own norms and values (remuneration norms) for acceptable remuneration ratios, pay for performance, sustainable value creation and public support for top salaries.
2.	Insufficient focus on the interests of stakeholders involved in remuneration, and appropriate management of their expectations.	Analyse the issue of remuneration from a variety of perspectives. Keep stakeholders informed about progress in ongoing projects and the input required from them. Manage their expectations on time.
3.	Insufficient preparation by remuneration committee when it comes to policy-related decisions: not enough time taken, no opportunities for rigorous discussions/ opinion-forming, no time for serious exploration and calculation of alternative scenarios.	Base remuneration proposals on a thorough scenario analysis with simulations for various performances by (a) the company; and (b) the financial markets (stock exchange), and create realistic and generous planning.

#	Pitfall	Remedy
4.	Mono-disciplinary approach to remuneration.	Arrange input from various disciplines, or (better still) organise multi-disciplinary work groups which are managed by the remuneration committee. Make sure control functions, compliance, risk management and the internal control department are involved in regular processes if remuneration presents a risk.
5.	Short-sightedness: unable to see beyond the board of directors.	Look deeper into the organisation so top executive remuneration is seen in relation to that of senior management and other employees, and is also placed in a broader financial perspective.
6.	Underestimation of communication.	Ensure short lines of communication with the corporate communication department or communication advisers. Obtain timely advice about the potential impact of remuneration decisions on reputation-related risks. Carefully plan the timing for communication.
7.	Disregard for other aspects of employment.	Regularly place issues like succession planning, executive talent development/fleet review on the agenda – even if there are no vacancies in the board of directors.
8.	Thinking that remuneration is only about money.	Make sure remuneration is effectively embedded into the annual performance management cycle. Make sure enough attention is also paid to personal, non-financial and immaterial aspects like appreciation and recognition.
9.	No interest in the expense claims of directors.	Make sure the remuneration committee regularly receives an overview of the expense claims submitted by directors. This will offer an insight into their claiming behaviour. Expense claims are an important indicator for culture and behaviour at the top.

(Conscience-related) issues for non-executive directors

About what are you most proud when it comes to remunerating top and sub-top managers in your organisation?

About what are you most concerned when it comes to fulfilling the role of the supervisory board in your organisation?

When is the next planned evaluation of remuneration policy by the supervisory board?

What are the main risks when it comes to remuneration in your organisation?

Who is – actually, not formally – responsible for overseeing implementation of remuneration policy in your organisation?

When was the last time you thoroughly discussed a remuneration issue with a fellow supervisory director?

Can you provide a strongly-worded definition for the evaluation framework used by the supervisory board? For instance, formulate own norms and values for remuneration (remuneration norms), for acceptable remuneration ratios, pay for performance, sustainable value creation and public support for top salaries.

5 questions for the next supervisory board meeting

1 Is the issue of director remuneration a concern for our directors? Is there (latent) dissatisfaction or frustration on this front?

2 Do we have a good insight into stakeholders when it comes to remuneration? Are we familiar with their interests?

3 Do we have an insight into the risks of remuneration, not only for the board of directors, but also in the lower echelons?

4 Do we have an insight into the costs associated with the remuneration packages of the board and senior management (for example, the top 100) for the coming three years, and in different scenarios for market and company performance?

5 How do we assess the effectiveness with which remuneration policy is implemented within the organisation (processes, procedures and decision-making)?

Governing remuneration: 3 areas of attention

1

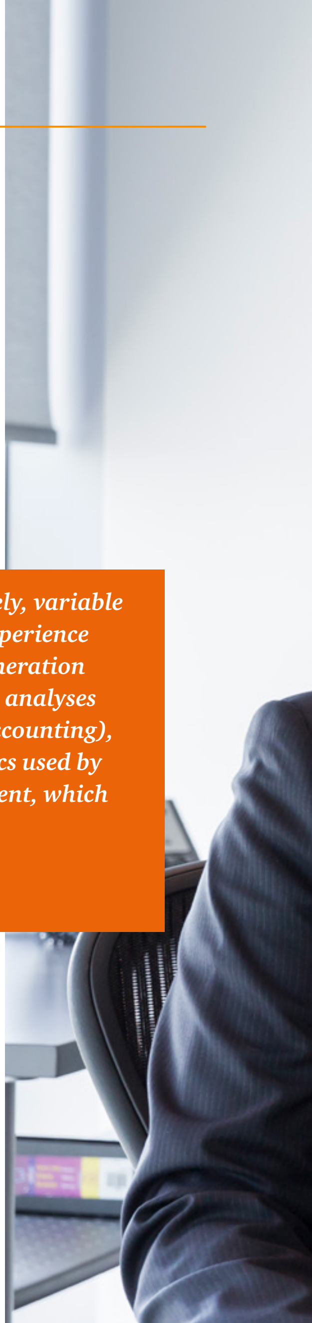
Remuneration and risks – from two perspectives: *(i) potential risks of the remuneration structure and the nature of incentive programmes; and (ii) remuneration as a risk that must be identified, and be monitored and controlled by line management and control functions.*

2

The financial impact of remuneration: *namely, variable remuneration, and the specific knowledge and experience needed to get a grip (be 'in control') on the remuneration of executive management – for instance, scenario analyses and stress tests, monitoring of costs (financial/accounting), dilution of shares – in short, the financial statistics used by the supervisory board as a management instrument, which require input from the financial department.*

3

Soft controls, culture and behaviour relating to responsible remuneration policy: *controls relating to 'soft' aspects such as culture, core values, ethics in business, corporate social responsibility, leadership, integrity, 'tone at the top', reputation and brand value – everything relating to a robust and responsible remuneration policy.*



Read more about remuneration

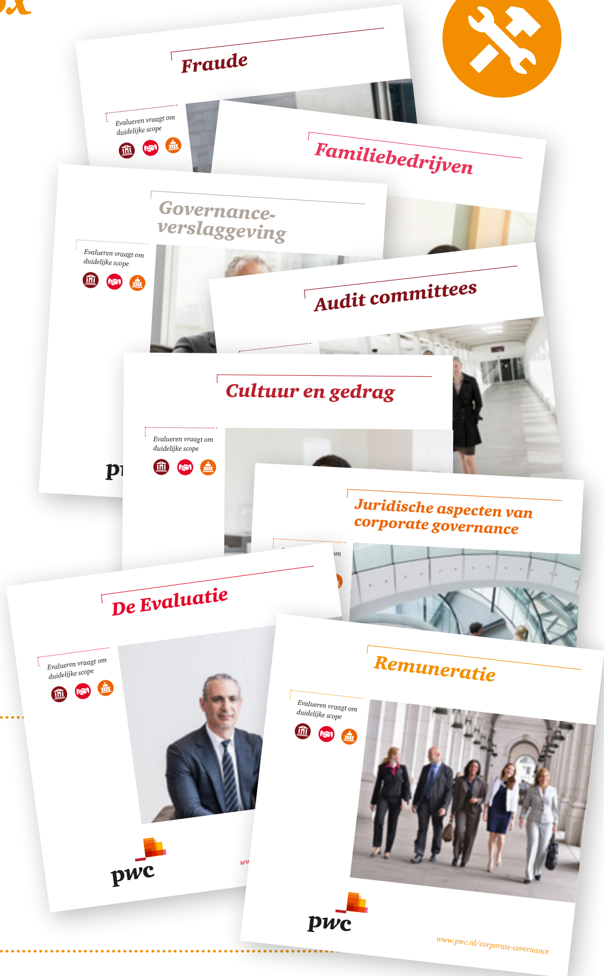
Please visit the following websites if you would like to read more about the issue of remuneration:

- Information on the Dutch People and Organisation practice: https://www.pwc.nl/nl/people-and-organisation.html
- Information on getting executive pay right:
  http://www.pwc.co.uk/services/human-resource-services/executive-pay-insights.html

Supervisory board toolbox

This booklet about ***Remuneration*** is part of a series of pocket-size booklets within the ***Supervisory board toolbox***.

This toolbox is specifically developed for Supervisory Board members and officials and contains booklets in which relevant corporate governance issues are addressed. *Remuneration*, *Evaluation*, *Get grip on culture and behavior*, *The non-executive director in the public sector* and *Mergers & Acquisitions booklets* are currently available. The series is further supplemented with topics such as *Family business*, *Audit committees*, *Fraud*, *Legal aspects of corporate governance* and *Reporting on governance*.



You can visit **pwc.nl/corporategovernance** to request already available pocket-size booklets or download them in digital version.

The website also allows you to register for email alerts so we can inform you when a new pocket-size booklet is available in the series.

Notes

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