WTW Statement to the draft Guidelines on the standardised presentation of a remuneration report under Directive EU 2017/828

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Why the guideline is important

From the point of view of an international Executive Compensation consultant we welcome the change that has happened across the member states of the EU in the past two years since the SRD implementation. Besides the increasing transparency with regards to disclosed information on remuneration design and pay for performance, we appreciate that investors across the EU have a similar level of influence with regards to "say-on-pay". However, we also see major challenges for our clients especially in those countries where say-on-pay was not common before and where the impact of the SRD in general was higher. The pressure and influence of proxy advisors and investors on the remuneration policies as well as on their remuneration reports is demanding and still increasing in many regions. This results in an increasing amount of time and work that companies have to invest in preparing remuneration reports as well as the annual shareholder meetings. In countries where the national legislation and / or corporate governance codes remain rather vague or leave room for interpretation after the transposition of the SRD, the challenges for the companies were significant in the first year of application.

We understand that the guidelines are non-binding and do neither create any legal obligations nor a technical standard and that companies must primarily comply with their applicable national legislation and national corporate governance codes locally. Nevertheless, in some countries the Directive 2017/828/EU was transposed to national legislation rather vaguely or some definitions were even misinterpreted. In addition, in some countries, e.g. Germany, the corporate governance code was amended and since then explicitly refers to the EU guidelines. Consequently, former guidelines on how to disclose remuneration are non-existent anymore and companies were expecting a final EU guideline to provide the necessary guidance. In the absence of concrete guidance companies simply tried to develop suitable disclosure approaches in order to meet both the national regulatory requirements as well as investor expectations. Consequently, the disclosure practices across EU member states aligned in some aspects, but with regards to disclosure of remuneration levels the comparability is still rather low. And even within the same country companies are currently handling the disclosure of remuneration tables differently. Having this in mind, we think that the guidelines should be as precise as possible to avoid any further misinterpretation and to achieve its aim "*to help companies disclose clear, understandable, comprehensive, consistent and comparable information on individual directors' remuneration*" across European Union.

In the following, please find our key suggestions and recommendations on possible amendments to the draft guidelines sorted by the corresponding section of the draft guidelines.

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Key Principles

Comprehensive, clear and understandable content – definition of different remuneration terms

In this section of the guideline the terms “remuneration awarded” and “remuneration due” are mentioned for the first time. Within the next sections further terms are used: “vested remuneration”, “remuneration granted in previous years / during the reported financial year”, “remuneration offered in previous years / during the reported financial year”, “total value of vested shares”, etc. We think it would be beneficial if the guidelines provide specific guidance, i.e., a definition of all remuneration terms used, maybe including examples. So far, only “award” and “vesting” are defined in footnotes 15 and 16 and “due” is defined in the former draft version. However, those only refer to variable remuneration and do not cover base salaries, benefits or pensions. As this section defines the key principles, it might be helpful to add the definitions of the different terms at the end of this section and as well provide examples.

Proposed definitions for discussion:

1. **Grant or remuneration granted**: means the attribution of an opportunity to earn variable remuneration after specific conditions of performance and/or time lapse are fulfilled.

2. **Accrual period** (according to footnote 19): the period of time for which performance is assessed and measured for the purposes of determining an award of share-based remuneration. The end of the accrual period does not necessarily coincide with the award moment. We would remove the word “grant” from here. The definition is duplicated in footnote 15, we suggest to remove it from footnote 19, and have the definition of accrual as footnote in that same page alongside footnote 15, like a new separate footnote.

3. **Award or remuneration awarded** (according to footnote 15): ‘Award’ means the attribution of variable remuneration after a specific accrual period, independently of the actual point in time where the awarded amount is legally entitled or actually paid.

4. **Deferral period** (according to footnote 21): the period occurring after the accrual period of any remuneration during which the individual is not the legal owner of this remuneration.

5. **Remuneration vested** (according to footnote 16): ‘vesting’ means the effect by which an individual becomes the legal owner of the variable remuneration awarded, independent of the instrument which is used for the payment or if the payment is subject to additional retention periods or clawback arrangements.

6. **Remuneration due (or paid out):** “remuneration paid during the fiscal year”

7. **Retention period** (according to footnote 20): the period of time after the vesting of shares or share options or after actual payment (“due”) during which the “asset” cannot be sold or accessed.

For different remuneration elements these definitions would be interpreted as follows:

Remuneration report for fiscal year (FY) n	Examples „awarded“
Base salary	Base salary paid during FY n
Benefits	Benefits paid (or which were legally entitled) during FY n
Annual Bonus – one-year variable compensation	Bonus amount based on performance measurement for fiscal year n and paid out in FY n+1
Annual Bonus of FY n, that has to be deferred in shares with a two year deferral period	Bonus amount based on performance measurement for fiscal year n
Annual Bonus of FY n-2, that has to be deferred in shares with a two year deferral period	Bonus of performance year n-2 was reported as awarded in year n-2. Therefore, nothing is to be reported as awarded for that amount in year n.
Long-term cash plan with four years vesting and performance period, granted / offered in FY n-3	The gross amount to be settled / paid after four years performance measurement at the end of FY n
Performance share units with three years vesting / performance period and one year holding period granted / offered in FY n-2	The value amount of performance shares after the end of the performance / vesting period at the end of FY n, irrespective of whether the holding period continues to apply (or applies into the future – n+1)
Pensions	For defined contribution plans, amount contributed within year n. For defined benefits plans, cost registered by the Company in their annual accounts in year n to keep the obligations for that specific individual

Remuneration report for fiscal year (FY) n	Examples „vested“
Base salary	Same as “awarded”
Benefits	Same as “awarded”
Bonus – one-year variable compensation	Same as “awarded”
Annual Bonus of FY n, that has to be deferred in shares with a two year deferral period	Not reported in year n because it will vest in year n+2
Bonus deferral of FY n-2, e.g. bonus has to be deferred in shares with a two year deferral period	Reported as vested
Long-term cash plan with four years vesting and performance period granted / offered in FY n-3	Same as “awarded”
Performance share units with three years vesting / performance period and one year holding period granted / offered in FY n-2	Same as “awarded”
Pensions	Same as “awarded”

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Remuneration report for fiscal year (FY) n	Examples „due“
Base salary	Same as “awarded”
Benefits	Same as “awarded”
Bonus – one-year variable compensation	Usually not reported in year n since it tends to be due in year n+1. If it were due in year n, then to be reported
Annual Bonus of FY n, that has to be deferred in shares with a two year deferral period	Not reported in year n since not yet due
Bonus year n-1	Usually reported as due in year n, unless legally claimable in year n-1
Bonus deferral of FY n-2, e.g. bonus has to be deferred in shares with a two year deferral period	Usually not reported in year n since it tends to be due in year n+1 (i.e. performance year is n-2, there are 2 years of deferral ‘n-1 and n’, thus due n+1). If it were due in year n, then to be reported
Long-term cash plan with four years vesting and performance period, granted / offered in FY n-3	Usually not reported in year n since it tends to be due in year n+1. If it were due in year n, then to be reported
Performance share units with three years vesting / performance period and one year holding period granted / offered in FY n-2	Usually not reported in year n since it tends to be due in year n+1. If it were due in year n, then to be reported
Pensions	Same as “awarded”

Cross-references

The guideline mentions that *“the report could also make cross-references to relevant background information published elsewhere in order to avoid unnecessary duplications*”, for example, the remuneration policy. Especially with regard to the remuneration policy we think that it would be easier for companies as well as investors to have standardized elements as an overview of the remuneration policy included in the remuneration report instead of adding a hyperlink to a separate document. This would support the aim to provide *“comprehensive, clear and understandable contents”.* Many companies already provide a brief overview of the remuneration policy in their report in a very clear and understandable way.

In the same passage it is mentioned in footnote 9 that going forward the term “sustainability information” is used instead of “non-financial information” as a more accurate one. From our viewpoint this is rather less accurate as sustainable information or ESG information is a subset of non-financial information. Especially the short-term variable remuneration / bonus of executive directors very often depends on the following criteria: financial KPIs either measured on corporate or business unit level, ESG metrics that might be of quantitative or qualitative nature, non-financial objectives that are not necessarily ESG metrics (often measured on an individual or collaborative performance level). We would propose to mention both ESG metrics as well as non-financial objectives to be more accurate. Especially with regard to the disclosure in table 4.

Standardised Presentation

Total Remuneration of Directors

As stated on page seven *“the purpose of this section of the Report is to show actual total remuneration of directors during the reported financial year and has been designed so as to avoid double counting or duplication of the same components of remuneration in different financial years’ total remuneration tables, particularly with regard to variable remuneration*”. Therefore, the guideline should be more precise concerning the type of remuneration to be disclosed in the table: is it remuneration awarded, due or vested? We understand that it may not had been the aim to provide information for all three perspectives as this would be time consuming and complex but however the most precise and traceable. However, the current description will result in different interpretations and consequently less transparent disclosures. We would recommend disclosing the 3 of them if aiming to completeness, traceability and minimisation of interpretation. Or if aiming for simplicity: reporting on awarded only.

The guideline does not mention the currency in which compensation elements should be disclosed, which is especially important if there are several different currencies among the directors. We assume that for the sake of transparency, data either needs to be disclosing both currencies, i.e., the original payment currency and the company’s headquarter country currency or a specific exchange rate needs to be applied (e.g., average daily rate over the full financial year).

An information that is completely missing in the guidelines is the disclosure of target and maximum remuneration levels. Also, the local transpositions of the SRD are missing this information. However, in many cases companies nevertheless disclose this information as it provides a more detailed transparency on pay for performance.

Share-based remuneration

The introduction to this section is actually misleading: “*This section should include information about all share-based remuneration granted or offered in the last financial year or in other way relevant for the last financial year*.”. At first sight it seems that only plans granted in the respective fiscal year need to be captured. However, it is obvious that the table only makes sense if all LTI tranches that are currently in place are illustrated in tables, as stated also in the explanatory notes *(“This column should present the number of share options or shares granted or offered in previous financial years which are held by the directors under deferral period and under retention period at the beginning of the reported financial year.’*)

Based on the explanatory notes, also the market value, the fair value as well as the vested value should be disclosed. Consequently, both tables would need more columns as currently only the number of shares / share options are captured but not the amounts mentioned above. We assume that consequently the table would be applied differently by companies to be able to illustrate the information in a clear and understandable manner, i.e. one table per LTI tranche that might also include the performance conditions and if possible the current status on target achievement.

Getting back to the aim and purpose of the guideline, i.e., providing more transparency and consistency in disclosure of director remuneration, we would rather recommend defining exactly what type of value for share / share option plans should be disclosed. The guideline states that *“In the interest of transparency, companies are advised to reflect in the Report the market value of shares, or underlying shares in the case of share options, at the time they are granted, are offered, or vest, as applicable. Companies may also wish to consider disclosing the fair value, determined according to*

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IFRS 2 methodology for accounting." We would rather recommend that reporting the fair value according to IFRS2 should be compulsory as well as reporting the market value: the former according to IFRS rules and the latter as the Company considers appropriate, of course indicating methodology of valuation for such market value (you may choose to regulate that as recommendation also, in our opinion). Thus, LTI plans would at least be consistently disclosed and comparable across EU member states through the IFRS values.

Information on how performance criteria were applied

It is stated that companies might adopt table 4 as needed to be able to capture their system appropriately. However, companies also would have to explain why they can't use the table. Currently the table is designed in a way that only pure additive approaches can easily be captured. However, there are different approaches to designing performance criteria to be observed in the market, i.e., additive approaches with modifiers / multipliers, multiplicative approaches as well as metrics that are defined as an underpin. Therefore, either additional options of the table are provided in the guideline or companies at least don't have to explain their reasons for amending the table according to their needs. This fact will be obvious based on the description of the variable pay scheme.

The wording has been changed: non-financial objectives are not mentioned anymore. As already explained above the conclusion that "sustainability information" is used instead of "non-financial information" going forward, is rather misleading as non-financial is not a subset of ESG, rather the opposite. On top, variable remuneration schemes for directors also have non-financial criteria (individual objectives) that don't have an ESG focus.

Comparative information on the change of remuneration and company performance

The guideline leaves much room for interpretation for the comparative information. This is especially the case for: definition of group of employees (worldwide or home country only), the remuneration elements to be considered to derive the average compensation, the performance metrics to be considered etc. This leads to a lot of different approaches in disclosing this comparative information. On the one hand this is completely fine as companies have a chance to create their own story. However, a comparison between companies will not be possible.

In the explanatory notes it is stated that *"If a director resigns or it is removed from his charge before completing a period of five years, the information should adapt to this time period accordingly, reflecting the relevant elements related to the length of his assignment*". The statement is not very precise, but we would assume that it is allowed to prorate the remuneration of the year, otherwise it might be misleading. Clear instructions should be given as to when data should be annualised (or partial year combination of two individual remuneration) for the purposes of multiyear comparison to avoid misleading percentages.