



Newsletter: **Executive remuneration in listed companies: European “say on pay” rules implemented in Belgium**

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Dear reader,

In our **Newsletter** of 21 May 2017, we informed you about the new European Shareholders' Rights Directive (Directive 2017/828 as regards the encouragement of long-term shareholder engagement, sometimes referred to as 'SRD II', hereafter the "Directive"). Among other things, the Directive contains provisions governing executive remuneration in EU listed companies, which are often described as the shareholder 'say on pay' rules.

The Directive was to be implemented in Belgium and other EU Member States by 10 June 2019 at the latest. Belgium missed that deadline. The Michel I government gave priority to the adoption of the Belgian Code on Companies and Associations. Since then, we have gone through a period of political instability compounded by the corona crisis, resulting in delays.

The Belgian law implementing the Directive (hereafter the "Law") was finally adopted on 28 April 2020 and published in the Belgian Official Gazette of 6 May 2020.

For Belgian listed companies the main changes that the Law will bring about are:

- **the requirement that the shareholders vote in advance on the remuneration policy -- until now, they only voted on the remuneration report, established after the facts; and**
- **the publication of figures comparing executive pay, company performance and average employee pay, as well as the ratio between the highest director pay (presumably CEO pay) and the lowest worker remuneration -- these are novelties in Belgium.**
- **until now, individual publication of the remuneration was only required for the CEO while for the other management or executive committee members only the aggregate figures were published; individual publication for other management members will henceforth be required only in companies that adopt the dual management model with a management council (directieraad / conseil de direction); for informal management or executive committees, aggregate figures will still suffice.**

This newsletter reviews the executive remuneration provisions in the Law and in the 2020 Belgian Corporate Governance Code.

We hope you enjoy the read!

1 Introduction

The Law amends the recently introduced Belgian Code on Companies and Associations to implement the Directive. The stated objective of the Directive was to overcome certain corporate governance shortcomings in European listed companies and to further promote long-term engagement of the shareholders.

The Directive applies to EU listed companies, i.e., companies having their registered office in one of the 27 EU Member States and whose shares are admitted to trading on a regulated market in the EU (like Euronext). (The Directive also applies in the UK, which implemented the Directive within the deadline of 10 June 2019.)

The Directive and the Law deal with corporate law and corporate governance matters like identification of shareholders, information of shareholders, facilitation of voting rights, transparency of institutional investors, asset managers and proxy advisors and rules on related party transactions. The Law also contains a series of mostly minor amendments to the Belgian Code on Companies and Associations to correct mistakes or inconsistencies in the first version of the Code.

HR practitioners will primarily be interested in the provisions dealing with the remuneration policy and the remuneration report, which are discussed in this newsletter.

2 Current Belgian law on the remuneration report and remuneration policy

Belgium listed companies already publish information on executive remuneration in the annual remuneration report, which is an integral part of the corporate governance statement in the annual report of the Board to the shareholders. The current format of the annual report contains a mixture of figures and policy and of backward and forward-looking information. Looking backward, it must contain figures on remuneration paid during the fiscal year to the CEO (individually) and the members of the management committee (collectively). Looking forward, it must contain certain limited information on the remuneration policy for the next two fiscal years.

3 Remuneration policy to be voted by the shareholders' meeting

The Directive and the Law now clearly distinguish between the remuneration policy and the remuneration report. Both documents must be submitted separately to shareholder votes. By separating the votes on policy (for the future) and report (for the past) the votes will become more meaningful. A vote on the policy effectively gives the shareholder decision-making power on what remuneration will look like in the company, i.e., the real 'say on pay'. The requirement to have a separate remuneration policy was also contained in the new Belgian Corporate Governance Code 2020 (see § 9 below).

The vote on the remuneration policy is binding. Once approved, companies can only pay remuneration to their directors in accordance with the approved policy. If a proposed new remuneration policy is rejected, the company should continue to pay the directors in accordance with the old, existing policy. As long as no policy is (yet) adopted, the company must continue to pay directors in accordance with existing practices.

Temporary derogations from the policy are permitted only if (1) they are justified by extraordinary circumstances where the deviation is necessary to serve the long-term interests and sustainability of the company as a whole or to assure its viability; and (2) they are granted following the procedural conditions set forth in the policy; and (3) they only concern elements of the policy from which a derogation is authorised.

The remuneration policy must be submitted to a vote by the shareholders' meeting at every material change and in any case at least every four years.

The text of the policy and the results of the vote must be published on the company's website and remain available there as long as the policy remains in force.

4 Content of the remuneration policy

The remuneration policy must explain how it contributes to the business strategy, long-term interests and sustainability of the company. It must be clear and understandable and must contain the following elements:

- (1) a description of the different components of fixed and variable remuneration, including all benefits in whatever form, which can be awarded to directors and their relative proportion;
- (2) an explanation as to how the pay and employment conditions of employees of the company were taken into account when setting the policy;
- (3) if the company awards variable pay, clear, comprehensive and varied criteria for the award, notably (a) the financial and non-financial performance criteria including where appropriate, corporate social responsibility criteria, (b) an explanation how the criteria contribute to the business strategy, long-term interests and sustainability of the company, (c) the methods used to determine whether the criteria are satisfied, and (d) information on any applicable deferral periods and on the possibility for the company to reclaim variable remuneration ('clawbacks');
- (4) if the company awards share-based remuneration, the applicable vesting and retention periods, and how the share-based remuneration contributes to the business strategy, long-term interests and sustainability of the company;
- (5) a description of the duration of the contracts or arrangements with directors and the applicable notice periods, the main characteristics of supplementary pension or early retirement schemes, the termination conditions and severance pay;
- (6) the decision-making process for policy review and implementation, including the measures taken to avoid or manage conflicts of interest and the role of the remuneration committee; and
- (7) whenever the policy is revised, a description and explanation of all significant changes and how the new policy takes into account the votes and views of shareholders on the remuneration policy and remuneration reports since the last vote.

Many Belgian listed companies already provide some or a lot of this information in their remuneration reports. Henceforth, the information will need to be much more explicit and it must be contained in a separate forward-looking policy document.

The “explanation as to how the pay and employment conditions of employees of the company were taken into account when setting the policy” is a very vague requirement, copied straight out of the Directive. This sentence does not necessarily mean that the employee representatives should be involved in the conception of the remuneration policy.

5 Content of the remuneration report

The Law will also change the mandatory content of the remuneration report. The report must provide a clear and comprehensive overview of the remuneration, including all benefits in whatever form, awarded or due over the last fiscal year to individual directors, including to newly recruited and to former directors. The new requirements will apply for the first time to the reports covering fiscal years that started after 30 June 2019, meaning for companies having a fiscal year coinciding with the calendar year to the report concerning 2020 published in 2021.

5.1 Individual remuneration data

The remuneration report must contain the following information regarding each individual director's remuneration during the fiscal year:

- (1)(a) the total remuneration awarded by the company or any group company, split out by component:
 - base pay;
 - variable pay (all remuneration linked to performance criteria, and the form in which it was paid);
 - pension (amounts paid or cost accrued during the service year, with a description of the applicable plan);
 - other remuneration components (cost or value of insurance and benefits in kind, with an explanation of the most important components);
- (b) the relative proportion of fixed and variable remuneration;
- (c) an explanation how the total remuneration complies with the adopted remuneration policy, including how it contributes to the long term performance; and
- (d) information on how the performance criteria were applied;
- (2) the number of shares and share options or other type of share-based remuneration, offered, granted, vested, exercised or expired during the fiscal year, their main attributes, the main conditions for the exercise of the rights including the exercise price and date and any change thereof;
- (3) in case of departure, the decision and justification by the Board of whether the director receives severance pay, as well as the calculation basis thereof;
- (4) information on the use of the possibility to reclaim variable remuneration ('clawback'); and
- (5) information on any deviations from the procedure for the implementation of the remuneration policy or any derogations from the policy, as well as the justifying exceptional circumstances.

5.2 Comparative pay & performance data

In addition, the remuneration report must also describe the annual change of the remuneration of directors, the evolution of the performance of the company and of the average remuneration on a full time equivalent basis of employees of the company other than directors, over a period of at least five fiscal years, presented together in a manner that permits comparison.

The idea behind this requirement of the Directive clearly is that the reader should be able to link executive pay with average employee pay and company performance. The Directive and the Law do not specify how this information should be “presented together”. The Law merely copies the language of the Directive on this item, without further specification. The text suggests that this could be done in the form of a table or a graph. For Belgium, this comparative data disclosure requirement is clearly the biggest novelty in the remuneration report.

5.3 Draft EU publications guidelines

In the meantime, the EU Commission is developing “Guidelines on the standardised presentation of the remuneration report”, which would apply to all listed companies throughout the EU. A draft of these guidelines was submitted for public consultation in March 2019. Publication of the final guidelines can be expected any time soon. The draft guidelines call for presentation of most of the required information in table form, in lines and columns, as defined in the guidelines. The guidelines will contain further specifications of the publication requirements, but will not be legally binding.

In respect of the comparative data disclosure (see 5.2 above), the draft guidelines stipulate that the average employee pay can be calculated at the level of the reporting company, or if the company finds this more meaningful, at group/consolidated level. Company performance can be measured in terms of net profit/loss or other relevant criteria. The five-year comparison can be gradually built up and does not need to be provided retroactively for the five previous years if this information is not readily available.

5.4 Belgian pay ratio disclosure

The requirements described above closely mirror the existing requirements and the text of the Directive. In the course of the debates in Belgian Parliament an additional publication requirement was added, which the Directive did not call for. Listed companies will henceforth need to disclose in the remuneration policy the ratio between (1) the highest remuneration of a director and (2) the lowest remuneration (expressed in full-time equivalent) of the other employees. Similar proposals on pay ratio disclosure had been made in the European Parliament during the debates on the Directive. EU Parliament members not only called for publication, but also “justification” of the ratio. The proposals did not obtain the required consensus. The five-year comparative data was the compromise solution that came out of the European legislative process. In Belgium, the mandatory pay ratio disclosure was inserted during the parliamentary debate in order to secure votes from the opposition in favour of the Law. The Belgian pay ratio disclosure is thus a perfect example of gold-plating of EU law. The Law does not impose to disclose a “justification” of the ratio.

Note that the comparative data disclosure is about director pay as compared to **average** employee pay, whereas the pay ratio disclosure is based on the **highest** director pay (presumably CEO pay) and the **lowest** employee pay (not the average). Average employee pay is information that could already easily be deduced from the company’s social balance sheet (and shall henceforth be published for the purpose of the comparative pay disclosure - see 5.2 above). Lowest employee pay is information that hitherto remained unpublished.

5.5 Privacy protection

It has been argued that the publication of individual remuneration data is inconsistent with the constitutional privacy protection and the General Data Protection Regulation. This argument has, however, been rejected. The Directive and the Law contain very limited privacy protection provisions. The remuneration report should not contain sensitive personal data (i.e. data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, genetic data, biometric data, data concerning health or data concerning a natural person's sex life or sexual orientation). Individual director data processing is only permitted for the purpose of the transparency to enable shareholders to supervise remuneration. The Directive and the Law also impose a 10-year limit on the publication of the data.

According to the Belgian Data Privacy Authority, whose advice was requested by the Parliament during the parliamentary debate, the purposes pursued by the data processing operations put in place by the Law are “*well defined, explicit and legitimate*”. The Authority insisted on the “data minimisation” principle, meaning that no other personal information than that required by the Law should be mentioned. The current Code on Companies and Associations states that the remuneration report must contain “*at least*” the required information. The words “at least” have now been deleted.

6 Who is a “director”?

The “director” definition is, of course, a key concept in the Directive and the Law, as the individual disclosure requirements only apply to “directors” as defined.

The current Belgian legislation required publication on an individual basis for non-executive directors and the CEO and on a collective basis for the (formal or informal) management committee.

The term “director” is broadly defined in the Directive as the CEO, the deputy CEO, and any member of the administrative, management or supervisory bodies of a company. The Directive left it to the Member States to determine whether other persons performing similar functions should also be considered as “directors”.

In Belgium, the current executive remuneration provisions in the Company Code (introduced by the Corporate Governance Act of 6 April 2010) apply both to a formal management committee (‘directiecomité’ or ‘comité de direction’), as defined by company law, and, where no such formal body exists, to an informal executive committee. Informal committees are caught under the concept of “other persons in charge of management” (“*andere personen belast met de leiding*” / “*autres dirigeants*”), defined as the members of any committee where the general management of the company is discussed and that is not set up as a formal management committee under the Company Code (e.g., an ‘executive committee’ or ‘group management team’ or other similar bodies).

In the first proposal submitted in Belgian Parliament, the individual disclosure requirements were extended to the members of a formal management council (in the new dual management model of the Code on Companies and Associations). For informal management bodies, only collective disclosure was proposed, thus staying within the strict scope of the definition of “director” in the Directive.

In the course of the debates in Parliament, the individual disclosure was further extended to the “other persons in charge of management”, using the possibility left by the Directive to Member States to also

consider other persons performing similar functions. In a last-minute change in the plenary session, this change was undone. In the end, **the Law thus imposes individual disclosure only for management council members in the dual model, not for informal management or executive committee members.**

It remains to be seen how many Belgian listed companies will adopt the “dual” management model with a supervisory board and a management council. The dual model may become less attractive for listed companies now that it implies additional individual disclosure of management remuneration.

7 Vote on the remuneration report

The Directive provides that the annual shareholders’ meeting has the right to hold an advisory vote on the remuneration report of the past financial year. As the report reflects historical data, a rejection will not affect remuneration paid, but will only send a signal to the directors. The company is required to explain in the next remuneration report how the vote by the shareholders’ meeting has been taken into account.

The vote as such is not new for Belgium. This principle was introduced in the Company Code by the Corporate Governance Act of 6 April 2010. What is new for Belgium, is the requirement to explain in next year’s report how the vote is taken into account.

8 Publication of the remuneration report

After the annual shareholders’ meeting, the remuneration report is to be published without delay on the company’s website. It must remain publicly available, free of charge, for 10 years.

As part of its audit, the statutory auditor must check that the remuneration report contains the required information.

The Directive also states that Member States must make their existing rules on director’s liability applicable to any breach of the remuneration report obligations.

These requirements are not new for Belgium. Directors were already subject to strict joint liability for any violations of the Company Code, including the provisions on remuneration reports.

9 Belgian Corporate Governance Code 2020

On 9 May 2019 the Belgian Corporate Governance Committee published the 2020 version of the Corporate Governance Code for listed Belgian companies, which entered into effect on 1 January 2020. The new Code focuses on the company’s long-term value creation, taking account of the interests of all shareholders and other stakeholders. It already anticipated on the entry into force of the Law.

The provisions of the Code are based on a “comply or explain approach”, *i.e.*, listed companies are not obliged to implement them, but should explain why if they do not. The new Code also contains recommendations for an increased level of detail of such explanations.

The most striking provisions of the new Code concerning directors' and executives' remuneration are:

9.1 Non-executive directors

For non-executive directors, the Code confirms and specifies the recommendation that they do not receive "any performance-related remuneration that is directly related to the results of the company". This goes beyond the legal requirements that (1) variable remuneration can only be awarded to non-executive directors subject to a condition precedent of shareholder approval, and (2) no variable remuneration can be awarded to independent non-executive directors.

In addition, for non-executive directors, the Code recommends that they do not receive stock options, but that part of their remuneration should be paid in the form of shares in the company. These shares should be held until at least one year after the end of the board mandate and at least three years after the time of award. The Code does not specify what portion of the remuneration should be paid in shares.

9.2 Executive directors and management members

The Code recommends that the board should set a minimum threshold of shares to be held by the executives. This shareholding requirement is entirely new for Belgium. It is different from the recommendation for non-executives, which is to pay (partially) in shares. For executives, the recommendation is not that they be paid in shares, but that they hold a number of shares (e.g. the equivalent of one year's remuneration, to be acquired over three years), which they could either purchase or receive in the context of share-based LTI-plans.

The Code suggests that when the company awards short-term variable remuneration to the executive management (e.g., an annual bonus), this remuneration should be subject to a cap. The Code does not specify what the cap should be. In the banking industry, Belgium has already introduced a 50% cap on variable pay. It would be appropriate for this cap to be defined in the remuneration policy (see § 4 above).

The Code confirms a minimum vesting and exercise period for stock options of at least three years. The same requirement is included in the Code on Companies and Associations, but a derogation is possible in the by-laws or by shareholders' resolution. Such derogation would now require an "explain" under the Corporate Governance Code. The Corporate Governance Code also recommends that the company does not facilitate hedging.

The Code suggests including claw-back clauses in executives' contracts, which would enable the company to recover variable remuneration paid or to withhold the payment of variable remuneration, in certain specified circumstances (that are not defined by the Code and left at the discretion of each company). The Code explicitly adds "insofar as enforceable by law" (which is not straightforward for executives who have employment contracts). Until now, listed companies were only obliged to disclose in the remuneration report whether they had such claw-back clauses in the contracts or not.

10 To be continued...

Publication of remuneration policies and data is not new in the EU. In recent years, various initiatives have been taken in Member States to promote shareholder 'say on pay'. In many countries there are more or less binding rules in corporate governance codes. Proxy advisors have for some time focused their attention on director remuneration.

Still, the Directive has brought the debate to a different level. Its requirements are now cast into national laws and non-compliance may result in sanctions.

The Directive thus certainly creates new rights for shareholders. By the same token, these rights are also obligations. Indeed, the Directive makes the shareholders' meeting the ultimate judge on director remuneration matters.

With these new rights and the increased transparency and disclosure, one might expect more lively debate on executive remuneration in shareholders' meetings in Belgium and throughout the EU in years to come...

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