AUTORITÉ DES MARCHÉS FINANCIERS

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French and European "say on pay" regimes

Over the last decade, the remuneration of listed company directors has been hotly disputed in Europe. In the UK, shareholders of many companies have made clear their opposition to high pays for directors that have presided over significant losses. In Germany, institutional investors and shareholders have made similar criticisms of what they see as a flawed system. Similar complaints have been registered in several EU Member States, including France and the Netherlands.

On 9 December 2016, the European Commission, Council and Parliament reached an agreement on a revision to Directive 2007/36/EC, the so-called Shareholder Rights Directive, introducing a “say on pay” for shareholders at EU level[1].

On the same day, the so-called “Sapin 2” law on transparency, anti-corruption and economic modernisation was announced in France, giving shareholders the right to vote on the remuneration of listed company directors. Although these two texts share comparable objectives, they have considerable differences as well as similarities.

The European say on pay regime

The future revised Shareholder Rights Directive grants shareholders a right to vote on the remuneration of directors of companies listed on a regulated market.

Directors are taken to mean the members of an administrative, management and supervisory body as well as the chief executive officer and deputy chief executive officer, if they are not members of such bodies. The Directive gives Member States the opportunity to also cover any person carrying out similar functions to those mentioned above.

It makes a clear distinction between the ex ante right to vote on remuneration policy (Article 9a) and the ex post right to vote on the remuneration report (Article 9b).

The ex ante right to vote on the remuneration policy

The Directive requires listed companies to establish a remuneration policy that describes, among other things, the various components of fixed and variable remuneration, including any bonuses or benefits of any kind that may be awarded to the directors.

Before it is implemented, this remuneration policy must be submitted to a vote at the annual general meeting (AGM) of shareholders at least every four years and upon any material change.

The shareholders' vote on the policy is binding since the companies are able to pay their directors only on the basis of a policy approved by the AGM. If the shareholders vote against the policy, it cannot be implemented by the company, which must instead pay its directors in accordance with the most recently approved policy. Should the company not have a policy that has previously been approved by the shareholders, it should pay its directors on the basis of existing practices. In both cases, the company is obliged to submit a revised policy for approval at the next AGM.

Member States may however determine that the shareholder vote be purely consultative, i.e. allow companies to pay their directors based on a policy that has merely been put to the vote of the AGM. If the shareholders reject the policy, the company must submit a revised policy to the next AGM.

Lastly, whatever the nature of the vote, the Directive enables Member States to authorise companies to temporarily depart from the remuneration policy, provided they indicate the procedural methods of this departure and the elements to which it applies. Such an option is available only in exceptional circumstances, i.e. when a departure from the policy is crucial for preserving the company's viability or long-term interests.

The ex post right to vote on the remuneration report

Listed companies must produce a remuneration report describing all compensation, including benefits of any kind, awarded or due to each of its directors for the most recent financial year.

In particular, this report breaks down the remuneration of each director by fixed and variable components, as well providing details on how performance-related criteria have been applied. For comparative purposes, the report also displays the annual change in each director's remuneration, as well as changes in the company's performance and in the average pay of its employees.

The remuneration policy is put to a shareholder vote at the AGM every year.

Shareholders are entitled to vote, on a consultative basis, on the report for the most recent financial year, and the next year's report must include a description of how the result of that vote has been taken into account.

Member states may allow small and mid-sized companies[2] to submit the report to the AGM for discussion but not for a vote. In such a case, the company is obliged to mention in the next report how said discussion has been taken into account.

The revised directive will come into force 20 days after its future publication in the Official Journal of the European Union. Member States will then have a transposition period of 24 months.

In any case, the say on pay regime adopted in France since 9 December 2016 is generally more strict than the one introduced by the Directive.

The French say on pay regime

Just like the revised Shareholder Rights Directive, the Sapin 2 law grants shareholders a right to vote on the remuneration of directors of companies listed in a regulated market, with entry into force staggered over time.

Although it does not use exactly the same terms as the Directive, the Sapin 2 law also makes a distinction between shareholders' right to vote on remuneration policy, applicable for AGMs taking place from 2017, and on the remuneration report, applicable from 2018[3].

The ex ante right to vote on the remuneration policy

The French Commercial Code requires boards of directors or supervisory boards to produce a report that details the fixed, variable and exceptional elements of total remuneration, as well as benefits of any kind awarded to directors as a result of their function.

The directors in question are chairmen, chief executives and deputy chief executives (in a one-tier board structure), and the sole chief executive and members of the management and supervisory boards (in a two-tier board structure). The field of directors covered would therefore appear narrower than that of the Directive since it does not expressly include all members of the board of directors.

Although it does not include the overriding term "remuneration policy" used by the Directive, the law states that "the principles and criteria used to calculate, divide up and award" the various elements of remuneration should be subjected to a shareholder vote at least once a year. It specifies that the approval of the AGM is required before any change can be made to these remuneration elements and upon each re-election of the directors in question.

Unlike the Directive, which makes provision for a consultative vote, the Sapin 2 law dictates that the shareholder vote on remuneration policy be binding. It also sets out the consequences of a negative vote: if the AGM rejects the resolution put before it, the previously approved principles and criteria shall continue to apply; in the absence of these, remuneration shall be determined in accordance with the pay awarded for the previous financial year or, failing that, in accordance with existing practice within the company.

The ex post right to vote on the remuneration report

The AGM decides on the aforementioned elements of remuneration (fixed, variable and exceptional elements comprising total pay and benefits of any kind) paid or awarded to each director in respect of the previous financial year. Since the remuneration of each director is the subject of a specific resolution, the shareholder vote takes place every year.

The directors in question are the same as those mentioned above, except for the members of the supervisory board.

Unlike the Directive, which provides for a consultative vote and even gives the option of the matter simply being discussed at the AGM, the Sapin 2 law requires a binding vote. It also sets out the consequences of the shareholders failing to approve the resolution: the fixed elements of remuneration are not affected, but the variable or exceptional elements awarded in respect of the previous financial year cannot be paid out unless the director's total pay package has been approved by the AGM.

As we have seen, the future revised Shareholder Rights Directive and the Sapin 2 law differ in certain areas. The French law introduces a regime that is generally more strict than the one contained in the European Directive[4], including two binding AGM votes on:

- before any payment is made, the principles and criteria used to calculate, divide up and award all the elements of executive remuneration;
- the remuneration elements and benefits of any kind paid or awarded to each director in respect of the previous financial year, with the variable and exceptional elements suspended if shareholders fail to approve the package.

The UK plans to adopt a system similar to the one provided for by the French law. With this in mind, in November 2016 the British government launched a public consultation on the planned corporate governance reforms that include, among other things, submitting all or part of director remuneration to a binding annual shareholder vote rather than a consultative vote, which is currently the case[5].

[1] This agreement was formally ratified by the EU Permanent Representatives Committee on 13 December 2016, by the European Parliament on 14 March 2017 and by the Council on 3rd April 2017.

[2] Companies that meet at least two of the following criteria: fewer than 250 employees during the financial year, a balance sheet total of less than €20 million and net turnover of less than €40 million.

[3] In 2017, shareholders will have a binding vote on remuneration policy, and those of companies governed by the AFEP-MEDEF corporate governance code will have a consultative vote on compensation that has been awarded.

[4] Since the revised Directive remains for minimum harmonisation, France is free to adopt and implement a stricter regime.

[5] Current UK law dictates that remuneration policy is subjected to a binding shareholder vote every three years, while the pay actually awarded to directors is subjected only to an annual consultative shareholder vote.

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