

## 7. Answering the say for no pay

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### 7.1 INTRODUCTION

Executive remuneration is the hottest topic in corporate governance. Remuneration is considered key in the alignment of the interests of management and shareholders. But until recently it was exclusively the board of directors that held the reins of executive remuneration. Shareholders were, at best, merely informed of the remuneration packages managers were provided with. Voicing the shareholders' views on pay was a footnote in the minutes of the general meetings. For a number of years now, however, there has been a wave of 'say on pay' legislation enacted in countries around the world, including the US, Australia, Italy, Belgium, the Netherlands, Sweden and so on. Shareholders are provided with the power to vote in some manner on the remuneration of top management. It is said that this say on pay shifts powers from the (supervisory) board back to the shareholders, enabling them to hold the reins of executive pay.

Over the last few years, in countries that have enacted say on pay legislation, the remuneration agenda item has been one of the most discussed. It is regularly found that shareholders have refused to approve this agenda item. According to Semler Brossy (2015, 2), every year between 1.4 to 2.7 per cent of the American Russell 3000 companies fail their say on pay vote. Consequently, the say on pay vote should also have an important signalling effect. Knowing shareholders will vote on the remuneration package, it is likely that boards will take into account that only appropriate remuneration packages will be backed. However, the most recent developments in say on pay practice indicate that the shift of power is far from absolute. Pay packages are still skyrocketing according to some studies (Weaver 2016), and the pay for performance relationship is low, according to many studies (Bebchuk and Fried 2004, 6). Studies of the effects of the say on pay in the American Dodd-Frank Act 2010 show that low support increases research and development, capital expenditures and dividends but it has no effect on the market value of the firm (Brunarski

et al. 2015). Say on pay does not automatically have a deterrent effect on pay packages, and the American system, whereby shareholders are not mandatorily provided with an annual say on pay, results in the insulation of shareholders from voting on the remuneration (Weaver 2016). The advisory nature of most say on pay systems is not helpful in mitigating the nonalignment of remuneration of the CEO and the shareholders' interests either. During the 2016 general meeting of Renault, the French car manufacturer in which the French government holds 20 per cent of the shares and 23.5 per cent of the voting rights (Renault 2015, 7), 54 per cent of the shares were voted against the remuneration package of €7.3 million for the CEO. The board of directors of Renault made the decision to leave the remuneration package unchanged, which upset the French government, including the president who threatened to introduce more stringent rules (Stothard and Chassany 2016).

Outside the United States the effects of say on pay, and more particularly how companies respond to the dissenting vote on the remuneration report, have not been addressed in a qualitative study. This research aims to fill this gap. It studies the effects of the voting down of the remuneration report, and suggests improvements to the existing system in light of the findings of companies' responses to dissenting shareholders.

The chapter proceeds as follows. Section 7.1 provides an overview of the current regulatory state of say on pay in the United Kingdom and Belgium. Both countries have introduced a mandatory but advisory say on pay vote on the remuneration report: the UK in 2002 and Belgium in 2012. Before the enactment of the law, both countries had an advisory say on pay in their corporate governance code. Section 7.2 studies the evolution of the voting results on the remuneration report in the UK and Belgium. In both countries, significantly more opposition can be found to the general meeting's remuneration report than to most other voting items. Section 7.3 surveys the companies that experienced a dissenting vote on their remuneration report over the last five years. Identifying the reasons that shareholders provide for a dissenting vote, the section also reviews the evolution of the stock price around the time the remuneration report was disapproved. Further, it addresses the adjustments of remuneration practices in the aftermath of a dissenting vote. Finally, the section highlights the effect of these adjustments on the voting outcome at the next general meeting. Section 7.4 discusses these findings and advises policy makers of a number of improvements to the say on pay mechanism.

## 7.2 THE LEGISLATIVE FRAMEWORK OF SAY ON PAY

### 7.2.1 The United Kingdom

Historically, the office of director is aligned in law with that of a trustee and is not entitled to be remunerated, unless explicitly provided for by the shareholders' meeting. In the case *Re George Newman & Co* (1895, 686), it was held that:

Directors have no right to be paid for their services, and cannot pay themselves or each other, or make presents to themselves out of the company's assets, unless authorized so to do by the instrument which regulates the company or by the shareholders at a properly convened meeting.

Hence it is up to the shareholders to set the remuneration package of the directors or authorize an alternative mechanism in the constitution. The latter mechanism is standard. It is common that the articles of association delegate the general meeting's power to authorize payment of directors' fees to the board (Mclaughlin 2013, 232). The Companies Act 1985 (UK), carried forward in the Companies Act 2006, stated that the shareholders must approve payments for loss of office as a director and the particulars of the proposed payments be made available (Companies Act 1985, s 312; Companies Act 2006, s 221). Exceptions are made for small payments of less than £200 (Companies Act 2006, s 221), for pensions, for the discharge of an existing legal obligation or damages for a breach of such an obligation (Companies Act 2006, s 220).

Since the late 1980s, interest in remuneration of directors has increased. The Cadbury Code of 1992 started a debate on shareholder involvement in the remuneration practices that has remained a political and regulatory issue up to the present day. In that Code it was only recommended that shareholders vote for service contracts of directors lasting for more than three years. Say on pay was not considered best practice. On the contrary, the Cadbury Committee (1992, [4.43]) considered say on pay to be unworkable:

A director's remuneration is not a matter which can be sensibly reduced to a vote for or against; were the vote to go against a particular remuneration package, the board would still have to determine the remuneration of the director concerned. In addition, there are such practical considerations as the need to agree directors' remuneration on appointment.

This view quickly changed. In 2002 the UK was the first country to adopt mandatory nonbinding shareholder votes on director compensation (say

on pay), according to The Directors' Remuneration Report Regulations 2002 (DRR). Directors of a listed company must provide a yearly remuneration report, which must be put to the vote of the general meeting of shareholders (Companies Act 1985, s 241A). Schedule 7A of the DRR 2002 provides the details of the content of the remuneration report. The first part must not be submitted to the external auditor's review, while the second part must be externally audited.

In the first part of the remuneration report, the following information must be provided:

1. The remuneration committee and its composition.
2. A statement of the company's policy on directors' remuneration, which must address: the performance conditions for each director for share options or a long-term incentive scheme (LTIP) and the reasons why these particular conditions have been selected; the methods for assessing whether the conditions have been met, if any; the external factors for comparison with other companies, if any; the amendments of the terms and conditions and entitlements not subject to performance conditions; the relative importance of the elements related to performance (and those not related to performance); the duration of contracts; and the notice periods and termination payments.
3. A line performance graph which compares the performance of the company's shares with those of an index.
4. The date of each service contract, the unexpired term and the details of any notice periods, any provision for compensation payable upon early termination of the contract, provisions allowing to understand the liability of the company for early termination.

In the second part of the remuneration report, audited information must be provided:

1. The remuneration of each director (split in fixed fees, bonuses, expenses, compensation for loss of office, other benefits and the total).
2. The nature of non-cash elements of remuneration.
3. The share options, with the awarding price, the exercise price, date and expiring date, the performance criteria, and the market price of the exercised share options as well as of the unexpired share options at the end of the year.
4. Any agreement or arrangement under which money or other assets may become receivable by a person and which includes one or more

- qualifying conditions with respect to service or performance that cannot be fulfilled within a single financial year (LTIP).
5. Details of the pension scheme and the excess retirement scheme.

In the Companies Act 2006 another remuneration issue is put to a shareholders' vote. Shareholder approval is required in advance of directors' service contracts of longer than two years. While it is only the term exceeding two years that needs shareholder approval (Companies Act 2006, s 188(2)), a copy of the entire proposed contract must be made available for inspection by the shareholders (Companies Act 2006, s 188(5)). More generally, all service contracts of directors must be held available for inspection free of charge at the company's registered office or a place specified in the regulations (Companies Act 2006, ss 227, 228). The DRR Regulations 2002 were re-enacted in schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

In June 2012, the Department for Business Innovation and Skills (BIS) released a consultation proposing a binding say on pay in the UK (BIS 2012b, 15). BIS found in a study that in a significant number of cases, the management of the company failed to respond to substantial shareholder opposition against the remuneration report, and argued that the advisory vote had limited effect (BIS 2012a, 11).<sup>1</sup> BIS proposed to introduce two separate votes. The first vote is for the policy report 'setting out all elements of a company's remuneration policy and key factors that were taken into account in setting the policy' (BIS 2012b, 4). This vote will be mandatory and binding when the remuneration policy is set or changed. The second, advisory vote regards the implementation of the policy, 'setting out actual payments to directors and details on the link between company performance and pay' (BIS 2012b, 4). It resulted in the Enterprise and Regulatory Reform Act 2013 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, which came into force on 1 October 2013.

The latest set of rules requires the remuneration report to contain three separate parts: an annual statement, the annual report on remuneration and the directors' remuneration policy. The annual statement can take the form of a letter of the chairman of the remuneration committee providing summarized information of the major decisions on directors'

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<sup>1</sup> BIS does not take into account the rejection of the remuneration report, but referred to four companies that experienced shareholder opposition of more than 20 per cent four times, in a time frame of nine years.

remuneration, substantial changes made and an explanation why these changes have been made.

The annual report on remuneration must contain the single total figure of remuneration of each director, with the total amount of salary and fees, all taxable benefits, receivables as a result of the achievement of performance measures related to a period ending in that year (short-term incentives), those for periods of more than one financial year (long-term incentives), the pension and any other item of remuneration. Each of these remuneration elements must be further set out in sufficient detail. The requirements resemble the DRR Regulations 2008 but also contain new requirements such as the aforementioned single total figure of remuneration. Another novelty is the disclosure of information regarding the votes of the resolutions to approve the remuneration report and the remuneration policy and 'where there was a significant percentage of votes against either such resolution, a summary of the reasons for those votes, as far as known to the directors, and any actions taken by the directors in response to those concerns' (Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, cl 23(c)). The UK Corporate Governance Code Provision E.2.2 was upgraded by the requirement of an explanation of what actions the board intends to take to understand the reasons behind the vote result when, according to the board, a significant proportion of votes have been cast against a resolution. However, the corporate governance provision envisages all resolutions, whereas the law only requires action of the board in case a remuneration resolution encounters significant dissent. Neither the Regulation nor the Corporate Governance Code provides guidance as to what should be considered a significant proportion. In the CG100 and Investor Group's Directors' Remuneration Reporting Guidance (2016, 24) it is suggested:

to consider votes against in excess of 20% as being significant, although there may be reasons why, for some companies, a higher or lower level might be more appropriate. . . . Companies may wish to consider disclosing in the annual remuneration report the level of votes against that they deem to be 'significant'.

The report continues by stating that this proportion can be taken as a benchmark if the number of votes withheld passes this threshold.

The third part is that the directors' remuneration policy must be submitted to a binding vote at least once every three years. Section 439A of the Companies Act 2006 requires the directors' remuneration policy to address the matters mentioned in s 421(2A) which refers to the statutory instruments that must make sure that 'any information required to be included in the report as to the policy of the company with respect to the

making of remuneration payments and payments for loss of office (within the meaning of Chapter 4A of Part 10) is to be set out in a separate part of the report'. This policy must be provided *in extenso* in the report and must set out the company's approach to all different aspects of the remuneration that can be found in the single total figure table, including the recruitment, the service contracts and the payments for loss of office.

### 7.2.2 Belgium<sup>2</sup>

The Belgian legal rules relating to compensation are straightforward: the company's articles of association (or, if they are silent, the general meeting of shareholders) determine both whether the directors shall be remunerated<sup>3</sup> (Companies Code 2012, art 517) and, if they are to be paid, the remuneration package for the services as board member (Willermain 2008, 236). Alternatively, the shareholders at the general meeting could indirectly decide to pay the directors by approving company accounts in which remuneration is included as a cost (Willermain 2008, 236, note 95). The general meeting of shareholders' decision about the remuneration of the directors only relates to the total amount granted to the board of directors. The board of directors decides how this total compensation package will be divided between the directors (Willermain 2008, 237).

In 2002, the statutory creation of a modified two-tier board structure in the Belgian Companies Code affected the director remuneration rules (Law of 2 August 2002, *Official Gazette* 22 August 2002). Firms have the option, through their articles of association, to empower the board of directors to delegate a large part of its powers to a management committee. In the event that the company's articles of association do not provide rules for setting the compensation of management committee members, the board of directors is empowered to set the remuneration package (Companies Code 2012, art 524). The board of directors has the power to set the pay of the corporate senior officers, such as members of the management board and officers empowered to execute the day-to-day management of the company. The duties of the executive board members are therefore split between board membership and providing their services as executives.

Shareholders' powers to determine executive compensation at Belgian

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<sup>2</sup> This part has been taken from my co-authored article Thomas and Van der Elst 2015, 675–8.

<sup>3</sup> The Belgian director can be remunerated, but does not have to be (Companies Code, art 517).

companies were increased after the financial crisis and the national and international debates regarding excessive remuneration of top executives. The law of 6 April 2010 altered the corporate governance rules for executive pay for listed and state-owned companies (Law of 6 April 2010, *Official Gazette* 23 April 2010). As a result, in their annual reports Belgian firms must now include a corporate governance statement, as well as a detailed remuneration report. Moreover, they must establish a remuneration committee, set criteria for the variable part of the executive remuneration and have generous golden parachutes approved by the shareholders.

In addition, the general meeting of shareholders must vote every year on the company's remuneration report; a say on pay vote. According to the Companies Act, the remuneration report must provide detailed information on eleven remuneration items: (i) the process the board used in developing the remuneration policy; (ii) a statement of how the directors applied the remuneration policy during the accounting period; (iii) the remuneration package of each individual non-executive board member; (iv) the remuneration that senior executive officers receive for their role as directors; (v) the criteria and procedure to grant performance-related pay to executive board members and senior executive officers; (vi) a detailed description of the individual remuneration package of the chief executive officer; (vii) a detailed description of the global remuneration package of the other senior executive officers; (viii) the number and main characteristics of shares, options and other rights granted, vested and/or executed; (ix) severance pay commitments; (x) the applied severance pay, if an executive board member or senior executive officer has departed; and (xi) clawback provisions for variable pay based on misleading financial information (Companies Code, art 96, § 3).

The shareholder vote is advisory, so that the company is not obliged to revise any contractual engagements. Nor does the disapproval of the remuneration report affect the validity of the company's financial statements. However, if the shareholders disapprove the remuneration report, the board of directors is likely to revise the company's remuneration policy.<sup>4</sup> The disapproval leaves the company in doubt as to which of the different remuneration report components drove the shareholders to vote against the report.

The law of 6 April 2010 amended the Belgian Companies Code to give shareholders further power to restrict the structuring of the variable remuneration package and the share-based remuneration of the executives. It

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<sup>4</sup> Reported in Belgian House of Representatives (22 December 2009), report 2336/001.



now requires a shareholder vote, or a facilitating article of association (Belgian House of Representatives 2009, 18),<sup>5</sup> if the remuneration package of an executive board member or a senior executive provides for variable remuneration of which more than half is based on performance criteria of one year or less, or grants more than one quarter of the variable remuneration based on performance criteria measured over less than two years, or awards more than one quarter of the variable remuneration based on performance criteria measured over less than three years (art 520ter Companies Code). This provision is not applicable if the variable part of the remuneration is less than 25 per cent of the total remuneration. Furthermore, the Belgian Companies Code also requires shareholder approval, or a facilitating article of association, to deviate from a minimum vesting period for shares and share-based remuneration. Shares must not be vested earlier than three years after they are granted, while share options or other share-based benefits must not be exercisable earlier than three years after they are granted (art 520ter, § 1 Companies Code; De Wulf, Van der Elst and Vermeesch 2010).<sup>6</sup> Finally, severance pay arrangements with executive directors and senior executive officers that exceed the amount of 12 months<sup>7</sup> remuneration<sup>8</sup> require the preapproval of the general meeting of shareholders.<sup>9</sup>

The 2010 legislation made a lot of the best practices of the Belgian Corporate Governance Code of 2009 redundant. The Corporate Governance Code contained no fewer than 18 ‘comply or explain’ provisions on the remuneration of the board of directors and senior management, relating to the principle that the company must compensate the directors and executive managers fairly and responsibly (Corporate Governance Committee 2009, 21–3). Next to five non-specific principles on the remuneration report and conflicts of interest regarding the fixation of remuneration, the Corporate Governance Code contains three provisions on the remuneration of non-executive directors, the remainder being provisions on the remuneration of the executive directors and managers,

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<sup>5</sup> Which the general meeting of shareholders must provide for in the amendment of the articles of association.

<sup>6</sup> This provision is not applicable if the variable part of the remuneration is less than 25 per cent of the total remuneration (De Wulf et al. 2010).

<sup>7</sup> In legal doctrine, it is debated whether the legislation requires the approval of the general meeting of shareholders from 12 months onwards (De Wulf et al. 2010, 946), or from 18 months onwards (Wyckaert and Boedts 2010, 306).

<sup>8</sup> The Dutch wording in the law is ‘wage’.

<sup>9</sup> The next general meeting of shareholders must preapprove this severance pay arrangement. The arrangement is null and void if this procedure is not applied.

the contracts of the latter and severance pay arrangements. For executive directors and managers, an appropriate part of the compensation must be tied to company performance and individual performance of these persons (Provision 7.11). Severance pay arrangements for early termination of the contract must be specified and should not exceed 12 months' fixed and variable pay or 18 months' pay except for justified reasons specified by the board of directors (Provision 7.17).

The Corporate Governance Code requires full transparency of the remuneration package of the CEO and of the other executive members in the remuneration report. Information on the compensation package should be split into fixed remuneration, variable remuneration, pensions and other remuneration elements (Provision 7.14–15). The criteria for setting the variable remuneration and the term of evaluation must also be disclosed in the remuneration report (Provision 7.12). Next, shareholders should be informed about the number of shares, options and other rights to acquire shares granted, executed and lapsed at individual level, including their key features (Provision 7.16). Share (option) schemes should be approved by a general meeting of shareholders and contain a vesting term of not less than three years (Provision 7.13).<sup>10</sup>

## 7.3 SAY ON PAY IN BELGIAN AND UK PRACTICE

### 7.3.1 Introduction

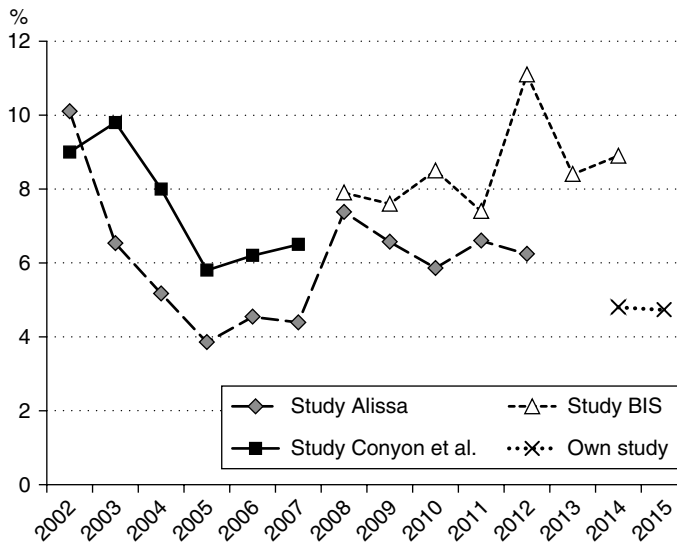
Say on pay legislation shifts power from the board of directors to the shareholders. While previously the board held the reins over the compensation packages of top executives, part of this power—depending on how the say on pay was enacted in a particular country—has shifted to the shareholders. Consequently, companies have to devote time in their reporting to remuneration practices. It immediately became clear that the vote provided shareholders with a powerful tool for ventilating their discontent. From the start in 2003, GlaxoSmithKline saw its remuneration resolution defeated because of the US-style pay package for its CEO, requiring a lot of effort from its chairman to restore the trust of its major shareholders and the investor community. Gradually say on pay was embedded in corporate governance practices. This section discusses the evolution of say on pay practices in the UK and Belgium.

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<sup>10</sup> The vesting term is a guideline that is not subject to the mandatory comply or explain part of the Code.

### 7.3.2 UK Practice of Say on Pay

The remuneration agenda item developed into the most critical item at many general meetings of shareholders, both in the UK and in Belgium. For the UK, both Conyon and Sadler (2010) and more recently BIS (2015) found that pay resolutions received on average three to five times more dissenting votes than other voting items. Figure 7.1 summarises the findings of these and two other studies. While non-voting items never breached the threshold of 3 per cent on average, the voting items went as high as 11 per cent on average in 2012, according to the BIS study. Over the longer term, the different studies indicate that say on pay started off with a high opposition rate in 2002, which fell in the years after its introduction. The years of the



Note: study Alissa: 217 companies of the FTSE 350 companies; study Conyon et al.: all listed companies in the proxy voting agency Manifest database; study BIS: 93 companies selected from large (>20000 employees), medium (<20000 employees) and small companies (SME EU definition) (for 2014 report and policy); own research: 226 companies of the FTSE 350 (Roy Coenders provided research assistance).

\*: Conyon’s study is based on all remuneration items: the directors’ remuneration report, resolutions on share options, on long-term incentive plans and resolutions related to bonuses.

Sources: Alissa 2015, table 2; Conyon and Sadler 2010, 304, figure 1; BIS 2015, 208, figure 16.

Figure 7.1 Evolution of the dissenting votes for the remuneration reports\* in the UK

financial crisis experienced an increase, after which the average dissenting levels further dropped to less than 5 per cent in 2015. This trend summarises the findings; a limited number of large companies sometimes experience high opposition, which was the case in 2012 when the BIS study, with its smaller sample, identified a peak in shareholder opposition. While the samples in the four studies presented in figure 7.1 are different, the dissatisfaction is calculated in a similar way: the total number of votes cast against the proposed item, together with the votes that were positively abstained or withheld, divided by the total votes cast and withheld. It is however common in the UK to report the proportion of votes cast for the agenda item, divided by the votes for and against, without the votes withheld being taken into account.

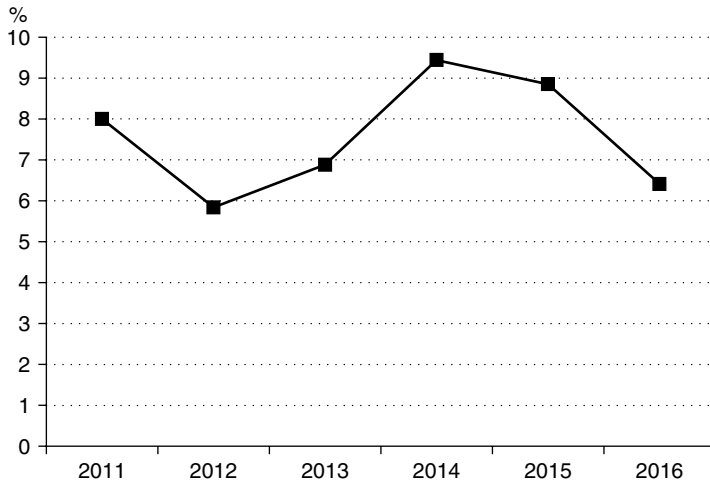
### **7.3.3 Belgian Practice of Say on Pay**

Starting in 2010 we collected all minutes of the meetings and / or voting results of all Belgian listed companies, which according to the Belgian Companies Code (arts 533bis, §2 and 546) must be disclosed on the companies' websites. In 2012 it became a mandatory requirement to disclose the results of votes of the general meeting. Previously the Belgian Corporate Governance Code, known in 2004 as the Lippens Code, contained provision 8.11 requiring the posting of the results of the votes and the minutes of the general meeting on the company's website as soon as possible after the meeting. The 2009 Belgian Code on Corporate Governance resumed and applied this provision literally. Hence companies had to disclose voting results or explain why they did not comply with this recommendation. An earlier study found that in 2011 approximately 60 per cent of companies complied with provision 8.11 (Van der Elst 2011).

Overall, voting items are seldom contested at AGMs of Belgian companies. In a study by ISS the average opposition was found to be 1.4 per cent in 2008 and 2.6 per cent in 2010. Only one item received more than 25 per cent dissent (ISS 2010). In 2009 this average was 8.2 per cent, but the proxy advisor did not provide specific information why the average differed significantly from the years before and after. Overall, opposition has increased recently. In 2015, the average opposition of agenda items soared to 4.6 per cent, equal to the 4.6 per cent in 2014 (ISS 2015). Most likely, some agenda items experienced high levels of dissent,<sup>11</sup> in particular the remuneration report. That can explain the difference with 2010 and 2008; the pre say on pay era.

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<sup>11</sup> For example, in 2012, the accounts of Cimescaut, a company that was delisted in 2013, were opposed with 35 per cent of the votes (Van der Elst 2013).



Sources: own research based on analysis of the minutes of the meetings of Belgian listed companies (sample sizes are: 2011: 10 (only a recommended voting item); 2012: 94; 2013: 95; 2014: 98; 2015: 103; 2016: 94. For 2016 not all companies had held their AGM).

Figure 7.2 Evolution of the dissenting votes for the remuneration reports in Belgium

As mentioned above, since 2012 the general meeting of shareholders must approve the remuneration report of Belgian listed companies, and the voting results are part of the disclosed information. We selected all these voting results from 2012 onwards and report the average results per year in figure 7.2. As the law was enacted in 2010, a limited number of ten companies already started having their remuneration reports approved in 2011 (Van der Elst 2012), while only being mandatorily obliged to do so from 2012 onwards. Results from 2011 are also included in figure 7.2.

In 2012, once the new say on pay law went into effect, over 90 per cent of the companies put the item 'remuneration report' on the agenda of the general meeting of shareholders.<sup>12</sup> The Belgian companies' remuneration reports received high levels of approval of approximately 94 per cent, higher than in 2011, when the 'voluntary' voting of the remuneration report resulted in an average dissent of 8 per cent. In Bel 20 companies,<sup>13</sup> the mean approval rate for remuneration reports was 90.6 per cent. A broader set

<sup>12</sup> The other companies did not comply with the law (Van der Elst 2013).

<sup>13</sup> Bel 20 is an index of 20 Belgian blue chip stocks.

of companies showed an even higher approval rate of 95.3 per cent. In the years after the introduction of the say on pay vote, however, shareholders of Belgian companies became more and more dissatisfied with the remuneration reports. In 2014, the average opposition almost reached 10 per cent and remained high—around 9 per cent—in 2015. In 2016 there was a significant drop in the average opposition rate to less than 7 per cent. The latter might be influenced by the fact that not all the data have yet been disclosed. However, as 85 per cent of the companies provided the results of their votes, it is more than likely that shareholders are more satisfied with the 2016 remuneration reports than with those in previous years.

Figure 7.2 conceals some companies where shareholder opposition was significant. Already in 2012, the shareholders of Agfa approved the company's remuneration report by a bare minimum, with only 50.3 per cent of votes cast in favour, while the AGM of EVS approved its report with 64 per cent, and only 69 per cent of the Delhaize shareholders approved its report (Van der Elst 2013, 15). Importantly, all three companies have a relatively dispersed ownership structure, and the other agenda items for the AGM, including the remuneration of the board members, were overwhelmingly approved (Van der Elst 2013, 16). Since 2013 each year has seen a limited number of general meetings during which shareholders voted down the remuneration report, while at a number of other meetings more than 20 per cent of the shareholders were dissatisfied with the report. The companies that experienced a disapproval of their remuneration report will be studied in the next section.

## 7.4 CORPORATE RESPONSE TO DISAPPROVED REMUNERATION REPORTS

### 7.4.1 United Kingdom

While the number of listed companies in the UK is much larger than in Belgium, the number of disapproved remuneration reports is less divergent. The research of BIS found that between 2007 and 2011 there were 11 companies in the FTSE All-Share Index that had their remuneration report disapproved (BIS 2012a, 11). This number increases to 19 if votes withheld are also counted. From 2012 to 2015, we found ten more companies that experienced a no vote on their remuneration report. These findings are based on reports of the National Association of Pension Funds, LexisNexis Market Tracker Trend Reports, Georgeson Proxy Season Reviews, Proxy Insight, Computershare and Capita Asset Services. For two companies, William Hill in 2012 and Diploma in 2015,

the remuneration report was legally approved as the withheld votes were not taken into account, resulting in 51 per cent and 57 per cent approval respectively.<sup>14</sup> Further, Kents Corporation failed the remuneration report vote in 2014, but later that year it was acquired by the Canadian SNC-Lavalin and there was no further follow up. The other companies that experienced the rejection of the remuneration report between 2012 and 2015 are reported in table 7.2. The voting results are based on the disclosed AGM results on the websites of the companies.<sup>15</sup> Aviva, Cairn Energy, Pendragon and WPP all had their remuneration reports disapproved in 2012, Afren in 2013, Burberry in 2014 and Intertek in 2015. The reports of Afren, Cairn Energy and Pendragon received supportive votes of less than one third of the total votes. For the other companies, only a small majority of the shareholders disapproved the report. Our analysis is limited to the say on pay of the remuneration report. The UK introduced a mandatory and binding say on pay of the remuneration policy in 2014. As far as ascertainable, voting policies have not been disapproved so far. Consequently, the remainder of this study disregards this voting item.<sup>16</sup>

At the AGM that followed upon the disapproval of the remuneration report, all but one company managed to get more than 90 per cent support for the new remuneration report. Only at WPP did a large number of shareholders remain concerned about the reported remuneration. WPP will be studied in more detail further in this chapter.

Next, we studied the letter of the chairman on the subsequent remuneration report, identifying what steps the company had taken following the disapproved report, which elements of the report the shareholders were dissatisfied with, as well as how the company adjusted the remuneration of the board and executives to regain shareholders' support. A summary of the findings can be found in table 7.2.

All companies started up discussions with shareholders, be it only with their largest shareholders or institutional shareholders, identifying the concerns which led them to oppose the remuneration report. Some companies went even beyond the group that voted at the meeting. Proxy agencies or representative bodies of shareholders, like the Association of British Insurers, can be helpful in understanding the arguments of shareholders that voted against the remuneration report, as some shareholders

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<sup>14</sup> If the yes votes are offset against the total votes, the approval rates would only have been 48.5 and 49.6 per cent.

<sup>15</sup> All AGM results are on file with the author.

<sup>16</sup> For a study on the evolution of the vote on the remuneration policy, see Van der Elst and Lafarre 2017.

*Table 7.1 Evolution of approval rates of the remuneration reports of UK companies of which at least one report was disapproved (%)*

	2012 report	2013 report	2014 report	2014 policy	2015 report	2016 report
Afren	71.40%	<u>20.29%</u>	91.78%	91.62%	in administration**	
Aviva	<u>45.59%</u>	99.29%	98.09%	96.88%	98.68%	96.36%
Burberry	96.95%	96.83%	<u>47.32%</u>	84.92%	92.27%	—*
Cairn Energy	<u>32.97%</u>	99.51%	99.30%	98.06%	98.59%	93.00%
Intertek	90.93%	94.02%	96.82%	96.44%	<u>47.88%</u>	96.48%
Pendragon	<u>32.21%</u>	97.87%	97.29%	99.31%	84.70%	91.46%
WPP	<u>40.48%</u>	80.58%	81.75%	81.93%	79.97%	66.55%

*Notes:*

\* AGM 2016 did not yet take place.

\*\* According to their website, the company Afren is under administration since 31 July 2015. In short, administration is a corporate rescue mechanism for companies that are operationally viable but facing serious threats from their creditors.

base their vote upon the advice of these bodies. The chairman of the remuneration committee of Cairn Energy reported contacts with ‘all relevant stakeholders’. It is unclear which other parties, next to shareholders and advisory bodies, should be engaged regarding the voting of the remuneration report.

Most subsequent remuneration reports disclose the important shareholders’ concerns that the company identified in its discussions with shareholders after the dissenting vote on the earlier report. The common triggering factor for many shareholders to vote against the remuneration report is the (procedure to award the) generous bonus, in particular when an insufficient relationship between the bonus and the performance of the company is evidenced. The weak link between performance and pay is closely related with another feature that shareholders consider critical: the discretion of the board or the remuneration committee in determining compliance with the goals for variable pay. We also discovered that not all companies report the concerns of their shareholders. This is a weakness in the current model of disclosing and voting on the remuneration report, as the final section will discuss.

All subsequent reports provide adjustments of the remuneration packages and/or policies of the executive directors in the aftermath of a no vote. Broadly speaking, companies opted for two types of changes. First, some companies such as Burberry changed the disclosure policy, in particular to illustrate the pay for performance packages of top executives better. Burberry’s subsequent DRR of 2014/15 shows very clearly that the



*Table 7.2 Summary of the effects of the disapproved remuneration report of UK companies*

Company (SOP dismissal)	Procedural follow up	Identified problem	Adjustment	Vote subsequent year
Intertek (2015)	Contacts with shareholders; deep dive review of all components	Reported subsequent DRR: joining arrangement and guaranteed bonus	Bonus is subject to performance criteria; change annual bonus; holding period of LTIP of six months post vesting retained; introduction of an all employee share plan	96.48%
Burberry (2014)	Contact with majority of 50 largest	Reported subsequent DRR: structure CEO package; too much discretion in policy; one million shares award 2013 (countering offer other brand); 0.5 million welcome of perf. shares	Better explanations, in particular details on performance conditions of share allowance; no changes in discretion (but infrequent application)	92.27%
Afren (2013)	Contact with institutional investors	Reported subsequent DRR: the payment of an additional exceptional performance award to Executive Directors for enhanced project delivery in addition to their annual bonus payment.	New annual bonus plan without this kind of award; 50% deferred bonus for three years; reduce to vesting of awards for achieving medium TSR to 25% (from 30%); CEO must have five years annual salary in shares; six months retention of shares granted in 2014 under share plan	91.78%

Table 7.2 (continued)

Company (SOP dismissal)	Procedural follow up	Identified problem	Adjustment	Vote subsequent year
Cairn Energy (2012)	'We will continue to engage with and listen closely to all relevant stakeholders'	Reported outside DRR: bonus award for moving from the role of Chief Executive to Chairman*	Reweighting of KPI for bonus scheme; assessment of the performance conditions governing the vesting of the LTIP awards; the adoption of certain changes to the termination provisions; the introduction of clawback provisions in the annual bonus scheme and LTIP; the creation of share ownership requirements; a change in the weighting of the elements used to determine the level of annual bonus for 2013; the amendment of the LTIP so as to give the Committee the flexibility to grant nil-cost options as well as conditional share awards	99.51%
WPP (2012)	A series of meetings with share owners and representative bodies to listen to their issues and concerns	No reporting	CEO's remuneration package has been reduced; STIP has been reformed; new reformed LTIP; leadership equity acquisition plan will be measured on a common currency basis only, with no application of a fairness review.	80.58%

Aviva (2012)	Major institutional shareholders and proxy agencies	No reporting in DRR but response is explained in detail: ensure that bonus payouts are more closely aligned to shareholder experience; make any future buyouts on the hire of senior executives on a strict 'like for like' basis	Continue regular dialogue with shareholders; base pay unchanged in 2013; no short-term bonus (would have been 52% of maximum); Chairman fees frozen in 2012; pension plan standardized; pay package more closely aligned with performance	99.29%
Pendragon (2012)	Engagement with a range of shareholders and advisory bodies	No reporting	Revised remuneration policy; annual bonus reduced to 100% instead of 150%; increased annual bonus requirements; vesting schedule of LTIP lowered to 30% (from 60% before); revised remuneration policy with annual cap variable pay; deferral of awards in company shares; reduction of LTIP, clawback; new structure of remuneration report	97.87%

Note: \* <[www.theguardian.com/business/2012/may/17/cairn-energy-shareholder-rebellion-pay](http://www.theguardian.com/business/2012/may/17/cairn-energy-shareholder-rebellion-pay)>, last accessed 1 June 2016.

decrease in profit before tax in the accounting period 2015/16 resulted in a sharp 75 per cent decline in the CEO's remuneration package, foregoing the share awards and long-term incentive.<sup>17</sup> Second, other companies have made significant changes in the structure and/or the incentivizing mechanisms of the remuneration package, in particular in schemes providing a short- and/or a long-term bonus for executives, intensifying targets or lowering maximum bonus targets.

The absolute amounts of the pay packages seem to be less of an issue, or at least it is less formally stressed as a criterion for voting against the remuneration report. Shareholders must be convinced that weak performance seriously reduces the pay of top executives. Anecdotal evidence shows that large remuneration packages alert shareholders to scrutinize the performance-pay relationship. The 2012 remuneration report of WPP, the advertising company, was voted down. While the total pay package of the CEO increased, the total shareholder return in 2013 was -13 per cent. WPP restructured the remuneration package of its top executive team. However, it did not clarify in its subsequent remuneration report which pay concerns led shareholders to issue the dissenting vote. As the remuneration package of its CEO is considered to be among the highest in the UK, shareholders continue to question the like-for-like performance growth of the company and the pay package (Budden and Oakley 2013, 16). The 2013 remuneration report experienced significant opposition of 20 per cent—or more than 25 per cent if withheld votes are counted—opposition rates that continued to be found in subsequent general meetings (table 7.1).

The amendment of the targets in the remuneration packages and policies does not necessarily result in an overall lower remuneration of the top executives, as WPP illustrates. At WPP the CEO experienced a decrease in basic salary of just over 10 per cent and a 20 per cent decrease in pension benefits (table 7.2). Conversely, the reformed LTIP and STIP turned out progressively to increase the remuneration of the CEO. In 2015 the CEO earned more than £70 million, probably the highest remuneration package ever given in the UK. Shareholder opposition is growing, but the remuneration report was approved by two thirds of the shareholders. Also, the chairman of the remuneration committee received 8.4 per cent no votes, as against 6.6 per cent in 2015 and only 1 per cent in 2014. It should be noted that the focus on the structure of the pay package, instead of the levels of pay, has recently been questioned. The Norwegian sovereign wealth

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<sup>17</sup> The total remuneration of the CEO was £7.5 million in 2014/15; it dropped to £1.9 million in 2015/16.

fund announced that it would also take into account pay levels before approving the remuneration item (Milne 2016, 1). The manager of Hermes Investment Management declared that she felt ‘highly uncomfortable’ with the ‘excessive’ size of the pay of WPP’s CEO (table 7.3) (Cookson 2016, 13).

We also assessed whether shareholders would take the share performance to pay relationship into account when voting on the remuneration report. Thereto, we consider the stock price development before and after the no vote. The share price at the start of the accounting period upon which the disapproved remuneration report is based is considered as 100 per cent. This period is identified as period T. Marked in the evolution of the stock price are the date of the general meeting that took place during accounting period T (and which thus voted on the remuneration report for period T-1), the end of accounting period T, the date of the general meeting that disapproved the remuneration report, the end of the subsequent accounting period and the date of the next general meeting that approved the subsequent remuneration report. The timeline is presented in figure 7.3.

Figure 7.4 provides the evolution of the share price of the companies that experienced a dissenting vote on the remuneration report. The majority of the companies experienced a significant decrease in share price, from 15 to over 50 per cent, during the accounting period after the general meeting that took place during the relevant accounting period. At first sight, this indicates that shareholders could take this evolution into consideration at the moment they vote on the remuneration report. However, Afren saw its share price increasing after the AGM on T-1 and the end of the accounting period T (see figure 7.4, left hand scale). At the moment the shareholders had to vote on the remuneration report, the share price of all but one had already started to soar (see point AGM No vote for DRR of T), while for Burberry and Afren it still was looking very promising. At the moment that the subsequent remuneration report had to be voted on, only two companies had a stock price that was lower than the price at the start of the criticized accounting period. In short, the shareholders of these companies seem not to have taken the evolution of the stock prices into consideration when they issued their no vote on the remuneration report.

#### 7.4.2 Belgium

In the previous section it was shown that dissatisfaction with the remuneration report is significantly higher than any other agenda item in the AGM, but the averages of dissatisfaction are seldom higher than ten

Table 7.3 Evolution of the remuneration package of the CEO of WPP (in £ thousands)

	Base salary	Benefits	DEPs <sup>a</sup>	Pension	STIP	LTIP	Total	Share price	Dividend
2010	1009	374	1081	400	2850	3629 <sup>e</sup>	9343 <sup>d</sup>	789	17.8
2011 (in report 11)	1306	459	1340	585	5005 <sup>e</sup>	5575 <sup>f</sup>	12961 <sup>d</sup>	675	24.6
2011 (in report 12)	1306	466	1339	585	5005	3239	11941		
2012	1300	356	940	586	3078	11368	17628	888	28.5
2013	1150	350	1101	460	4115	22670	29846	1380	34.2
2014	1150	453 <sup>b</sup>	1288	456	3590	36041	42978	1345	38.2
2015	1150	200	1545	460	4278	62783	70416	1563	44.7

Notes:

- a Dividend Equivalent Payments;
  - b report of 2015 discloses 179 as the CEO paid 274 spouses travel costs back;
  - c LEAP value on vest/deferral date;
  - d due to different disclosed amounts, the total differs from the sum;
  - e 2011 Annual cash bonus and deferred share bonus (annual report mentions 5005 on p. 137 and 3696 on p. 138);
  - f LEAP award.
- Summary of data based on disclosures in the DRR of the company.

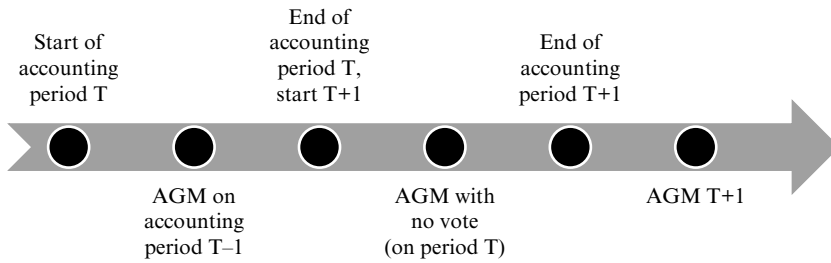


Figure 7.3 Timeline of stock price evolution of companies that experienced a no vote on the remuneration report

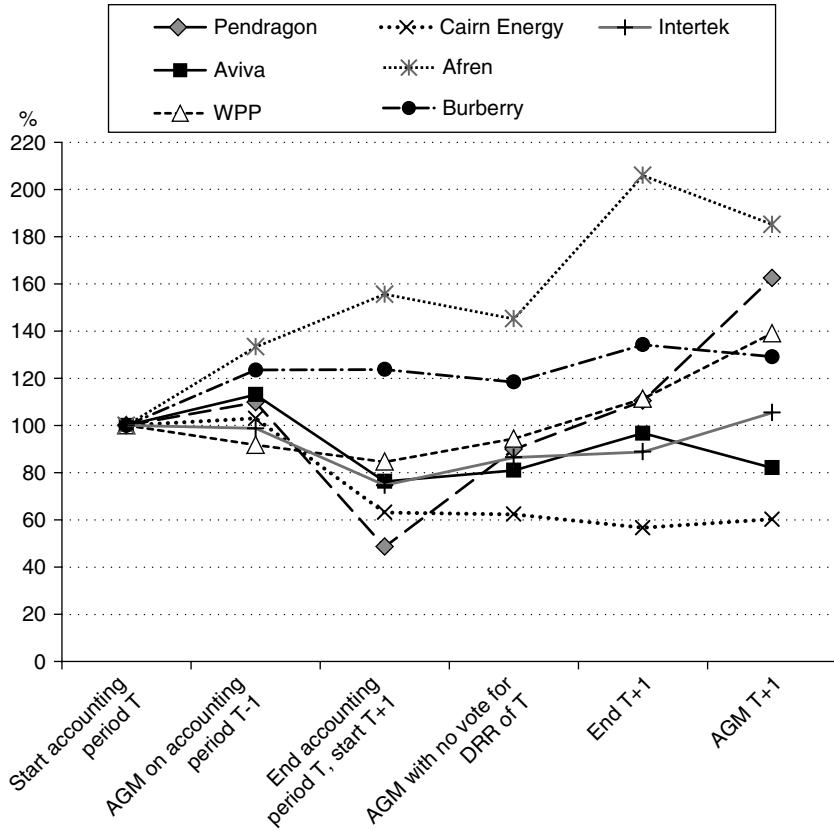
per cent. However, some companies did experience a disapproval of the remuneration report. Our database of the Belgian AGM voting results shows that between 2012 and 2016, six companies had one or more remuneration reports voted down. It happened for the first time in 2013 at the meetings of Proximus<sup>18</sup> and Galapagos. In 2014, at the meetings of Fagron and Agfa Gevaert, the remuneration reports were voted down, while Delhaize and (for a second consecutive time) Fagron had their remuneration reports disapproved in 2015. In all cases dissatisfaction with the remuneration report was very high. At the 2013 meeting of Proximus only five per cent of the represented shares approved the report, while at the meeting of Nyrstar in 2015 only one of every five represented rights voted yes. The other disapproved remuneration reports received between 55 per cent and 75 per cent no votes.

Unlike the subsequent UK AGMs, where a large majority of shareholders approved the adjusted reports, in the majority of the Belgian subsequent AGMs a large number of shareholders remained concerned that the remuneration report contained, in their view, inappropriate remuneration issues. Aside from the specific Proximus case, which will be discussed next, two companies managed to address all shareholder concerns, receiving approval of the new report by more than 97 per cent.

Which drivers activated shareholders to express their dissatisfaction with the remuneration report has not been studied in Belgium with the exception of the specific case of Proximus. The size of the CEO remuneration package of this government-controlled telecom operator had already been questioned for a number of years.<sup>19</sup> The

<sup>18</sup> Formerly Belgacom.

<sup>19</sup> When the CEO's contract was extended in 2009, it was announced that the size of his remuneration package had to be significantly reduced. However, his remuneration stayed at a similar level in 2009 and 2010 (BM and BBD 19 March 2012).



Sources: Pendragon, <[www.pendragonplc.com/investors/share\\_price/](http://www.pendragonplc.com/investors/share_price/)>; Aviva, <[www.aviva.com/investor-relations/share-price/ordinary-shares/share\\_chart/](http://www.aviva.com/investor-relations/share-price/ordinary-shares/share_chart/)>; WPP, <<http://wpp.co.uk/wpp/investor/shareprice/historic/>>; Cairn, <<http://cairnenergy.com/index.asp?pageid=168>>; London Stock Exchange, <[www.londonstockexchange.com/exchange/prices-and-markets/stocks/summary/](http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/summary/)>; Quotenet, <[www.quotenet.com/stocks/historical-prices/](http://www.quotenet.com/stocks/historical-prices/)>.

Figure 7.4 Stock price evolution of UK companies before and after a no vote

Socialist party that (together with the Catholic and Liberal parties) controlled the government during that era, and that for many years was considered supportive of former Proximus CEO Didier Bellens, lost its confidence in Bellens in 2013. As a result, at the 2013 general meeting the shareholders disapproved the remuneration report. The government withheld its votes, while over 70 per cent of the remaining



*Table 7.4 Evolution of approval rates of the remuneration reports of Belgian companies of which at least one report was disapproved*

	2012	2013	2014	2015	2016
Proximus	89.10%	5.07%	92.31%*	98.19%	97.57%
Fagron	95.99%	84.21%	43.96%	45.33%	72.44%
Nyrstar	85.61%	77.84%	58.05%	<b>20.55%</b>	99.91%
Delhaize	69.61%	89.12%	52.40%	45.63%	52.02%
Agfa Gevaert	50.28%	55.60%	33.96%	97.59%	95.55%
Galapagos	99.66%	25.69%	60.13%	60.96%	55.93%

Note: \* 79.97% withheld votes.

Source: own research based on the minutes of the meetings of listed companies.

shareholders<sup>20</sup> voted against the report because it again showed overly generous remuneration packages for the managers and directors.<sup>21</sup> Later that year, Bellens was dismissed and replaced (Temmerman 2013). The new CEO had to agree on a salary of maximum €650,000, less than half the remuneration package of the previous CEO (Van Belle 2014). In 2014 the remuneration report of Proximus was approved, although the government still abstained.<sup>22</sup>

The arguments for disapproving other remuneration reports, and the responses of companies confronted with dissatisfied shareholders, have not previously been studied. Similar to our study of the reasons for voting against the UK remuneration reports and the responses of the UK companies which had their remuneration report disapproved, Belgian disapproved remuneration reports and responses were assessed. A summary of findings is presented in table 7.5.

In contrast to the UK companies, not all Belgian companies consulted with their major shareholders in the aftermath of a disapproved remuneration report. The subsequent remuneration report of Nyrstar disclosed a

<sup>20</sup> Only 5 per cent of the attending shareholders supported the remuneration report.

<sup>21</sup> The minutes of the meeting are available at <[www.belgacom.com/assets/content/mbimport/%7B6B2D2E46-9049-46DA-8C21-1BB1DCAF3C1A%7D?transformationID=CustomContent&contentType=content/custom&previewSite=cow](http://www.belgacom.com/assets/content/mbimport/%7B6B2D2E46-9049-46DA-8C21-1BB1DCAF3C1A%7D?transformationID=CustomContent&contentType=content/custom&previewSite=cow)> (last accessed 3 May 2013), archived at <<http://perma.cc/GB8Y-F3A3>>.

<sup>22</sup> The minutes of the meeting are available at <[www.belgacom.com/assets/content/mbimport/%7B4685B5C8-7E07-486D-A94F-7AD0F9AC23E3%7D?transformationID=CustomContent&contentType=content/custom&previewSite=cow](http://www.belgacom.com/assets/content/mbimport/%7B4685B5C8-7E07-486D-A94F-7AD0F9AC23E3%7D?transformationID=CustomContent&contentType=content/custom&previewSite=cow)> (last accessed 20 August 2014), archived at <<http://perma.cc/6E9C-PH88>>.

*Table 7.5 Summary of the effects of the disapproved remuneration report of Belgian companies*

Company (SOP dismissal)	Discussion with shareholders	Identified problem	Details	Adjustment	Subsequent year's vote
Nyrstar (2015)	No information in follow-up remuneration report	No information in follow-up remuneration report	No information in follow-up remuneration report	In the minutes of the year of rejection: re-evaluation of remuneration policy; provide additional disclosure on the performance criteria under the short-term variable remuneration plan for the executive management of the Company. In addition, while the meeting in 2013 previously approved the implementation of a Leveraged Employee Share Ownership Plan, the Board will reconsider the further implementation of this plan	99.91%
Fagron (2014)	The chairman states during the AGM and after the dissenting vote that in the past the company has explained why – based on reasons that are company specific – it deviated from some	The annual report provides in one explanation related to the loss of office of 18 months fixed and variable pay, whereas a maximum of		There is no plan to change, in the next two years, the remuneration policy of the executive directors and the members of the executive committee	45.33%

<p>corporate governance principles. These explanations, in accordance with the Code, have been provided in the annual report. The chairman opines that some of the shareholders are voting in accordance with the recommendations of proxy advisors without taking into account the company-specific reasons and arguments for deviating from best practices</p>	<p>12 months is recommended in the code</p>	
<p>Fagron (2015)</p>	<p>Idem previous year</p>	<p>72.44%</p>
<p>Delhaize (2015)</p>	<p>One-off elements in 2014 (such as pay-out in 2014 of retention awards granted in 2013, which lie outside the framework of the remuneration policy)</p>	<p>The company has made some additional changes to some programmes (such as moving away from accelerated vesting of equity-based instruments following involuntary termination without cause or voluntary for good reason), and to its disclosure</p> <p>52.02%</p>

Table 7.5 continued

Company (SOP dismissal)	Discussion with shareholders	Identified problem	Details	Adjustment	Subsequent year's vote
Agfa Gevaert (2014)	The company contacted those 'Top 25 Institutional Shareholders' that voted against the 2013 Remuneration Report, as well as ten other known larger shareholders	Shareholders expect us to disclose additional information	More detailed disclosure on our remuneration policies and practices, as well as on our performance metrics	Very detailed information on calculation of remuneration of 'management employees'	97.59%
Galapagos (2013)	The company would attempt to gather information from its shareholders so as to better understand this result, in order to submit to the shareholders at the Annual General Shareholders' Meeting of 2014 a Remuneration Report relating to the financial year ending on 31 December 2013 that meets their expectations	No information in follow-up remuneration report	No information in follow-up remuneration report	Not indicated at all	60.13%

number of adjustments to satisfy shareholders, but it remained unclear how the company identified the causes of the no vote. However, the adjusted remuneration report received almost unanimous support. It should be noted that in the meantime a new shareholder, Trafigura, gained a significant voting block in Nyrstar (approximately 25 per cent). During the Nyrstar 2015 AGM two representatives of this shareholder Trafigura were elected, via a shareholder proposal, as directors of Nyrstar. Hence if these representatives supported the new remuneration report, the company could be confident that the shareholders would approve the report during the subsequent meeting. Indeed, the voting block of Trafigura represents approximately two thirds of the attending votes of the 2016 general meeting of Nyrstar, and the meeting approved the report.

Another company, Fagron, not only did not consult its shareholders after the defeat of its remuneration report, but the chairman of the board was angered that shareholders voted against the report. According to the minutes of the meeting he declared that ‘the remuneration report is an integral part of the annual report in which it is explained from which provisions in the Corporate Governance Code the remuneration report deviates’. The chairman continued that ‘the company already in the past had explained why the company—based on reasons that are company-specific—considers it desirable to deviate from some corporate governance “regulations”<sup>23</sup> which were, in accordance with the Corporate Governance Code explained in a comply or explain manner in the annual report’. He opined that ‘the new shareholder structure creates the problem that some of the shareholders are voting negatively in accordance with the recommendations of the proxy advisors for the only reason that some elements are not in compliance with the Corporate Governance Code, irrespective the underlying and company-specific reasons and arguments of the company to deviate from these points’.<sup>24</sup> The shareholders did not raise any questions before the agenda item was voted. The minutes of the meeting of the AGM of the subsequent year, during which the remuneration report was again disapproved, contains identical remarks by the chairman. The company not only did not consult the shareholders, but also made clear that the board of directors considered the negative advisory vote of the

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<sup>23</sup> The Belgian Corporate Governance Code does not use the term ‘regulation’.

<sup>24</sup> Author’s own translation of the minutes of the meeting of Fagron on 12 May 2014, 11.

Table 7.6 Remuneration of top management of Fagron 2013–15

In € thousands	CEO			Other members exec. com.		
	2013	2014	2015	2013	2014	2015
Base salary	500	600	598	1174	1009	1882
Variable remuneration	600	720	0	410	430	222
Pensions and other remuneration	32	31	35	30	0	108
Granted warrants	0	0	0	0	0	0
Number of share options/ warrants	325,000	200,000	75,000	265,000	115,000	397,875

shareholders inappropriate. Before the dissenting vote on the second remuneration report, the shareholders raised a number of questions. However, those questions were related to the new Warrant Plan, and it is hard to see how this plan could have influenced the shareholders' no vote. For the second year in a row, the company announced that there were no plans to make adjustments to its remuneration policy. The remuneration package of both the CEO and the other members of the executive committee remained more or less unchanged (though the composition of the committee changed), with the exception of the short-term bonus, which was curbed in 2015 as the targets were not reached (table 7.6).

While the approach of the board of directors and the chairman, blaming the inappropriate dissenting votes of the majority of participating shareholders, can hardly be considered cooperative, the response of the shareholders is of limited value. The shareholders are ventilating their discontent with the remuneration report. If shareholders do not stand up during the meeting and disclose their reasons for disapproving the report, the board of directors might consider this response of the chairman of the board as sufficient. The logic of this shareholder voicing is difficult to interpret. After two disapprovals, a third, similar, remuneration report of Fagron was approved. During the Q&A that preceded the vote, one of the shareholders addressed for the first time a particular remuneration report issue: the termination benefits of 18 months for the previous CEO, which the shareholder considered excessive. This issue was explained in the previous remuneration reports as the main deviation from the best compensation practices in the Belgian Corporate Governance Code. It might have been expected that this shareholder would have raised the issue during one of the previous

general meetings.<sup>25</sup> In the meantime, some shareholders that agreed to recapitalize the company<sup>26</sup> have thus acquired larger stakes in the company and are already involved in the management of the company, and it is therefore reasonable to assume that they are supportive of the current remuneration report and its included remuneration policy.

Belgian companies that have consulted their shareholders do not necessarily report the results of the inquiry, nor the arguments of the shareholders nor the adjustments the company has taken to align the remuneration report with the views of consulted shareholders. Galapagos announced that it would try to identify the reasons for shareholders' disapproving the remuneration report, but never disclosed the results of its inquiry. Two other companies addressed the defeat of the report and the ensuing actions in more detail. Agfa explained in a very detailed manner the performance metrics which were used, as well as the ways to calculate the remuneration of the top management. As far as we could ascertain, the remuneration policy itself was not adjusted. Delhaize identified that (according to the responding shareholders) the no vote was related to the inadequacy of the remuneration itself. Following these findings, the company 'has made some additional changes to some programs'. While the shareholders appreciated the approach of the former company and were satisfied with the additional disclosure, 'some additional changes' were considered as largely insufficient by a large number of Delhaize shareholders. Consequently, while Agfa had its subsequent remuneration report approved with a more than 97 per cent vote, Delhaize's subsequent report was considered barely sufficient, as only 52 per cent of shareholders supported it.

Anecdotal evidence shows that the presentation of the adjustments might significantly influence the support of the shareholders. Previously we noted that Agfa extensively addressed the measures of performance and the accompanying remuneration packages of the management, while no major changes to this package were introduced. The subsequent report received a very high level of support. Galapagos did not report on any kind of adjustments of the remuneration package or policies. The subsequent report was only approved with a majority of 60 per cent. In the latter case, it could be that the remuneration practices were adjusted without explicitly disclosing the new practices. Therefore, we also compared the remuneration policy and packages, as well as goals and

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<sup>25</sup> However, it is not known whether this shareholder was also present and/or a shareholder in the previous accounting periods.

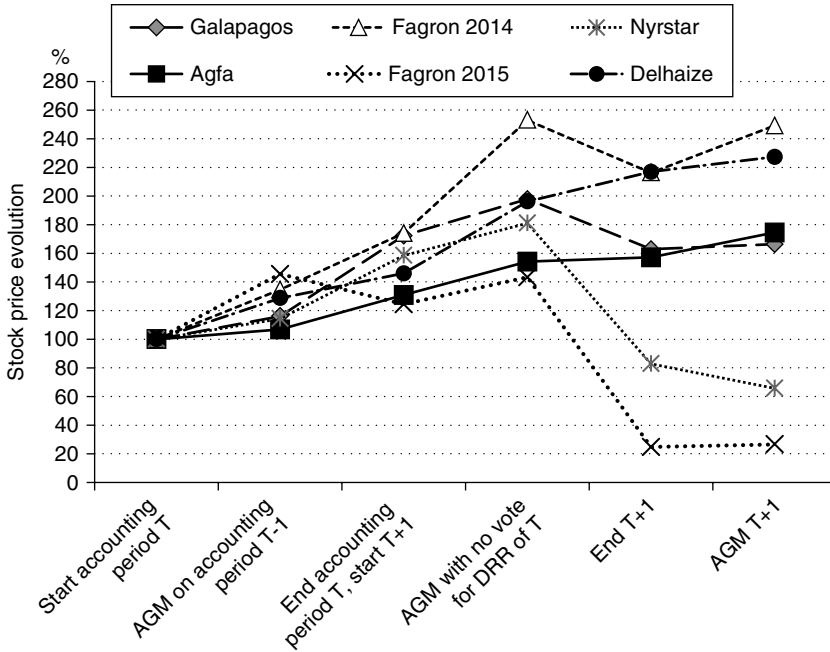
<sup>26</sup> All information on these recapitalization procedures can be found on the website of the company <[www.fagron.be](http://www.fagron.be)> last accessed 15 June 2016.

metrics that the company is using for motivating the management of the company, between the year during which the remuneration report was disapproved and those of the subsequent year. We found two differences. First, the goals for setting the short-term bonus were adjusted. The bonus is partially dependent on the goals of the company. In 2012 these goals included 'elements of revenue, cash flow, operating profitability, clinical trial results and licensing', all of which were considered to be of equal importance (Galapagos 2012, 21), while in 2013 they included 'elements of revenue, operating profitability, clinical trial progression and business development', again all of equal importance (Galapagos 2013, 22). Next, the 2013 report added a new discretionary power for the board. It can grant 'exceptional special bonuses, outside the scope of the regular bonus schemes . . . upon recommendation of the Nomination and Remuneration Committee in the event of and for exceptional achievements' (Galapagos 2013, 23). More discretionary power for the board of directors is generally less appreciated by shareholders. Therefore it could be that the lower level of support for the new remuneration report was partially due to this newly granted right for the board of directors.

For the UK companies, we studied the relationship of share performance to pay before and after the no vote. Similarly, for the Belgian companies we investigated whether shareholders take the share price development into account in voting against the remuneration report. Figure 7.5 shows the evolution of the share price of companies that experienced a dissenting vote on the remuneration report. The share price at the start of the accounting period related to which the remuneration report is disapproved is considered as 100 per cent. We included the stock price at the general meeting that took place during the accounting period, the stock price at the end of the accounting period, the stock price at the time of the general meeting that disapproved the remuneration report, the stock price at the end of the subsequent accounting period and the stock price at the time of the next general meeting that approved or disapproved the subsequent remuneration report.

In contrast to the UK companies, all Belgian companies experienced a significant increase in share price of 7–45 per cent during the accounting period, and all but one company's shares continued to soar after the accounting period running to the general meeting that disapproved the remuneration report. The share price development after the no vote shows a mixed picture. For Nyrstar and Fagron in 2015, the stock price dramatically dropped to levels that required capital increases, while the share price of other companies increased. Overall, the results confirm the UK findings. The share price developments as such seem unrelated to the no vote on the remuneration report.





Source: Euronext.

Figure 7.5 Stock price evolution of Belgian companies before and after a no vote

## 7.5 DISCUSSION AND CONCLUSION

This qualitative study of the effects of a no vote on the remuneration report shows that since its inception say on pay has regularly resulted in disapproved remuneration reports. Say on pay established a new trend in shareholders voicing their discontent with boards' decision and policy-making. Previously, the shareholders' voice was only exceptionally heard.

The disapproval of a remuneration report signals to the board of directors that responding is key. In the UK especially, boards are alert for this dissenting opinion and directors are discussing with shareholders which remuneration elements have raised the latter's concern. The chairman of the remuneration committee reports the reasons that the company has identified as drivers for dissent, and the subsequent report provides details of measures to align remuneration practices with the interests of shareholders. Belgian companies are less transparent. Some companies do not disclose

any reason why shareholders could have disapproved the remuneration report, and one blames shareholders for following the 'one size fits all' opinion of proxy advisors. At best, Belgian companies are more transparent about the applied remuneration practices. Consequently, support for the subsequent remuneration report of Belgian companies remains significantly lower than that of shareholders in the UK after a dissenting vote.

Further, our study shows how the process of say on pay could be further improved, especially in Belgium. While the legislator provides in detail how the remuneration report should be structured, the shareholder can only approve or disapprove the overall report. Shareholders can disclose their opinion on how they will cast their vote either before or during the general meeting, but few shareholders are actively disseminating their voting intentions. After the votes have been cast, only the UK provides guidelines of the steps that the company must take: it must identify the reasons for the dissenting votes and outline the actions taken in response. The effect of these guidelines is visible. The Belgian reports are vague and hardly informative in the follow up to the dissenting vote, while UK companies address these issues in their reports. It is recommended that Belgium provide guidelines similar to those applicable in the UK.

There is another issue that regulators can consider, related to the vote on the remuneration report. Boards of directors can, but are not compelled to take measures after the company experiences a no vote. This is a key feature of an advisory vote. Hence, the phenomenon of say on pay is at odds with the traditional legal framework. It is the first item on the agenda of the shareholders that is legally consolidated with an advisory vote in most countries that introduced say on pay. Contrary to many other 'corporate governance code-related' proposals, say on pay is being upgraded in the Corporate Act or Code. This upgrade only concerns the duty to organize a shareholder's vote. The voting result is not binding.<sup>27</sup> If other AGM agenda items are not supported by a majority of votes, they are consequently rejected and the board of directors is not allowed to execute the rejected proposal. But when it comes to the remuneration report, we find that Fagron experienced a dissenting vote twice but did not amend its remuneration practices, and neither did the shareholders express their reasons for disapproving those remuneration reports.

Also, some other boards provided some minor changes to the remuneration practices, like the board of Delhaize, or the board could convince shareholders that it was a one-time occurrence, like the board

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<sup>27</sup> There are exceptions, such as the UK vote on the remuneration policy, which is binding.

of Burberry. Tiny changes can do the job, but the voting results of the subsequent general meeting of Delhaize show that shareholders expected an in-depth review. Consequently, even when the vote for the remuneration report is only advisory and/or the second remuneration report is approved, it risks unnecessary escalation towards other binding issues or voting items when the shareholders' concerns over remuneration practices are not taken seriously.<sup>28</sup> Van der Elst and Lafarre show that when shareholders of the Dutch company Vastned disagreed with a proposed additional bonus, they refused to discharge the supervisory board (Van der Elst and Lafarre 2017). Only when Vastned's board promised not to provide these kinds of bonuses in future did the shareholders approve the discharge of the board members in the follow-up general meeting. Similar shareholder opposition could be found at the meeting of Heineken. However, as this company is family controlled, only the majority of the outsider shareholders disapproved the discharge of the supervisory board. It is reasonable to expect similar behaviour from shareholders that disagree with the remuneration report and experience a poor response from the board of directors.

Therefore it might be considered adding, next to the aforementioned guidelines, that after a dissenting vote, the vote for the subsequent remuneration report is binding and that the board must, if the report is voted down for a second time, take measures to amend the remuneration practices in accordance with the views of shareholders. This duty should be shared with the shareholders. Shareholders that continue to be dissatisfied with the remuneration practices must disclose their arguments for disapproving the subsequent remuneration report. At first sight this rule resembles the Australian two-strike rule. However, our proposal does not require a resolution to determine whether the board must stand for re-election (Thomas and Van der Elst 2015, 670–73). Neither does it set the threshold at 25 per cent, as the Australian rule does. However, the latter can serve as an example to structure the process. The combination of an advisory and a binding vote will also solve the awkward voting results for the remuneration report at Fagron, where the remuneration report was disapproved twice and yet the third, still unchanged remuneration report was supported. The combination of a first advisory and second binding vote for the remuneration report can also prevent other institutional changes<sup>29</sup> that disturb this fragile equilibrium of the first advisory vote on the remuneration report.

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<sup>28</sup> We refer to the Vastned case, see below.

<sup>29</sup> As the Renault case illustrates (see introduction).

The combination of an advisory and a subsequent binding vote could also strengthen the binding vote for the remuneration policy that was implemented in the UK and is proposed at European level, as the company should not only apply an approved remuneration policy but also adhere to remuneration practices that shareholders support. The remuneration policy should in particular address the issue of 'golden hello' or other welcome packages. Currently, the remuneration report is backward-looking; shareholders are informed too late of the entrance fees of executives. This was the major concern of the shareholders of Intertek and Burberry when disapproving their remuneration reports.

Related to the previous finding as to the fragile nature of a mandatory advisory vote, we also noticed that a majority vote of the shareholders is no longer considered sufficient support for the board's behaviour. Although it was not part of this investigation of current voting practices, we observed that the remuneration resolution must be adopted with an overwhelming majority before the remuneration practices are considered appropriate. Depending on the source, dissenting votes of 10 per cent, 20 per cent or 30 per cent require a response from the company, its board of directors and remuneration committee. A response is even mandatory in the UK when 'significant dissent' (an undefined standard) is registered.<sup>30</sup> Previously, it was shown that the CG100 requires the board of directors to take action as soon as the remuneration item is not supported by at least 80 per cent of the represented shares at the meeting. This practice shifts the remuneration issue from a common agenda item to a special agenda item. It is common practice in many countries that decisions which are considered pivotal for companies, like a change of the articles of association or a merger or division of the company, require supermajority approval. As the remuneration item must be supported with a majority of 80 per cent of the attending shares, a similar supermajority requirement is de facto introduced.<sup>31</sup> When the remuneration item is not approved with more than 80 per cent, the board of directors must also

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<sup>30</sup> In Australia the 25 per cent dissenting votes threshold can be considered a special majority, as in the two strike rule there is the opportunity to 'spill the board' if the company remuneration report receives a negative reception of 25 per cent of the votes at two consecutive AGMs (Corporations Act 2001, s 300A(1)(g); see also Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011, Explanatory Memorandum, 6).

<sup>31</sup> It must be noted that important decisions of the general meeting not only need supermajority approval but often also a minimum quorum requirement, which is not required for the approval of the remuneration item.

take action for lowering the number of dissenting votes for the remuneration item.

To the extent that many of these features are addressed in the proposal for a new European shareholder rights directive, we support this directive. Our findings suggest that remuneration is a key topic for developing a sound debate between the board and the shareholders.

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