Compensation Reporting in Europe: A Progress Report

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Director compensation and executive pay are staying under the microscope and continues to feature quite regularly in the headlines of many European markets.

One widely reported event was the Swiss public referendum on executive pay held in March 2013. This resulted in two-thirds of voters supporting 24 measures proposed by a Swiss senator to prevent executive pay robbery. Provisions include far-reaching shareholder rights and penalties up to criminal sanctions for non compliance. The first applications of the new regulations apply from January 2014 and are expected to make Switzerland one of the most heavily regulated countries on director/executive pay.

More executive pay restrictions are under way in many European countries with new rules likely to focus on the following areas:

- 'Tolerable' ratios/amounts for pay mix, one-off payments, specific contractual clauses
- The individualized executive pay and benefit data that must be disclosed
- The relationship between the pay of directors and the pay of ordinary workers
- The appointment terms/periods of directors
- Tax deductibility of personnel expenses, marginal income tax rates for high earners
- The rights of shareholders and investors.

Under recent European Union (EU) legislative developments, financial services compensation will be further constrained. For example, from 2014, the bonuses of material risk-takers employed by banks in the EU must be capped at a maximum of 100 percent of annual base salary (or maximum of 200 percent — with explicit shareholder approval). These regulations also apply to material risk-takers employed by subsidiaries of European banks and working outside the EU (e.g., based in the Far East or the United States).

Beyond banking, other important regulations for financial services institutions have been or are being introduced for key employees working in insurance, asset management, hedge funds, private equity firms, real estate funds, etc.

Compensation Disclosure

Results of an analysis by the author's company of European compensation reports showed that the standard of executive pay disclosures has risen further during the 2013 reporting season.

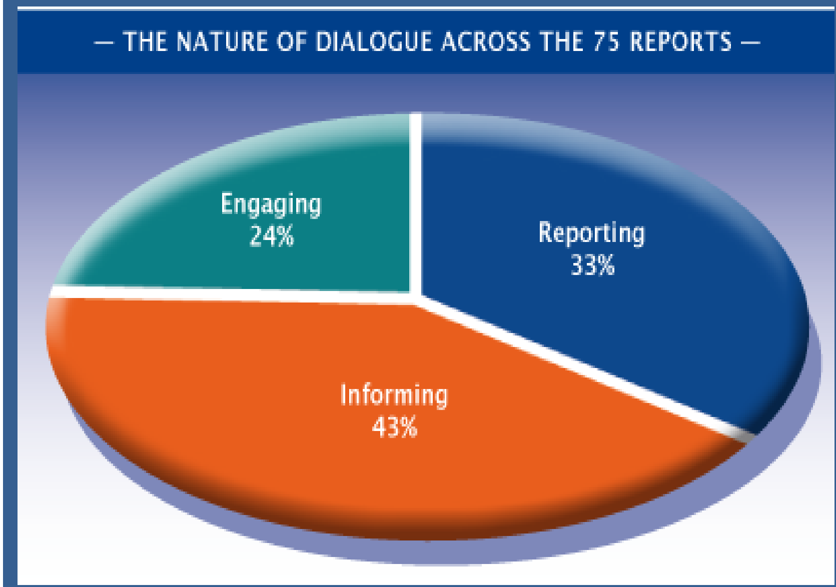
Approximately 15 percent of the pan-European sample of 75 blue-chip companies appear to have recognized the need to either redesign or significantly upgrade their reports.

The top two changes involved improvements to transparency and the addition of illustrations or graphics to support a better understanding of compensation plans and their governance.

Year-over-year improvement is particularly visible in the United Kingdom reports, with the full sample now falling into the top category of the *Remuneration Reporting Dialogue Continuum™*, established by the author's company. In their 2013 disclosures, several UK multinationals already anticipate some of the new reporting requirements applicable from October 2013. This includes splitting the compensation report into two sections, a policy report and an implementation report. The new requirements will also make it mandatory to provide a single total compensation figure for each director.

As was with the 2012 compensation disclosures, reports were assessed against defined criteria over five evaluation dimensions and then placed in one of three categories on a continuum stretching from 'reporting' through 'informing' to 'engaging'.

Figure 1: The Nature of Dialogue



Source: HR ValueCurve

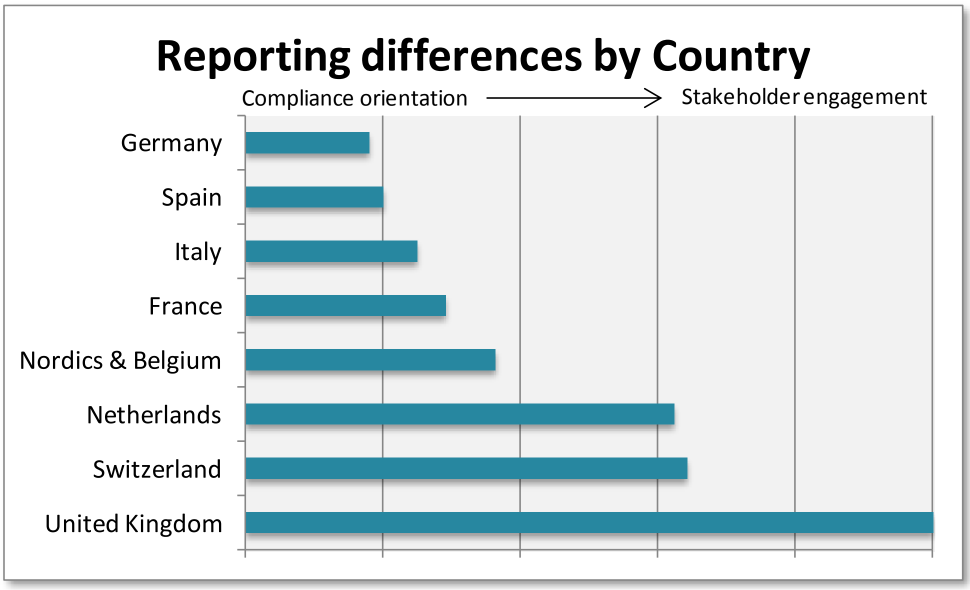
Overall, the results showed that one-third of reports were considered to be 'reporting', somewhat less than half 'informing', and almost one-quarter 'engaging' (see Figure 1).

Approximately one-third of the sample reports moved an additional notch toward the 'engaging' end of the continuum. This confirms the view that standards continue to improve as companies comply with increasingly onerous regulations and/or respond to high stakeholder interest in this area of corporate reporting.

Having said that, a company's decision on how to present its disclosures (i.e., the nature and style or tone of its communication on executive pay) should always be a conscious choice, and there are several factors to be considered here.

As was found in the 2012 study, the primary factor influencing reporting style is Country, with companies in certain countries undertaking mostly compliance-oriented 'reporting', companies in other countries primarily 'informing' their audience well and companies in one or two countries 'engaging' in a deeper dialogue with stakeholders (see Figure 2).

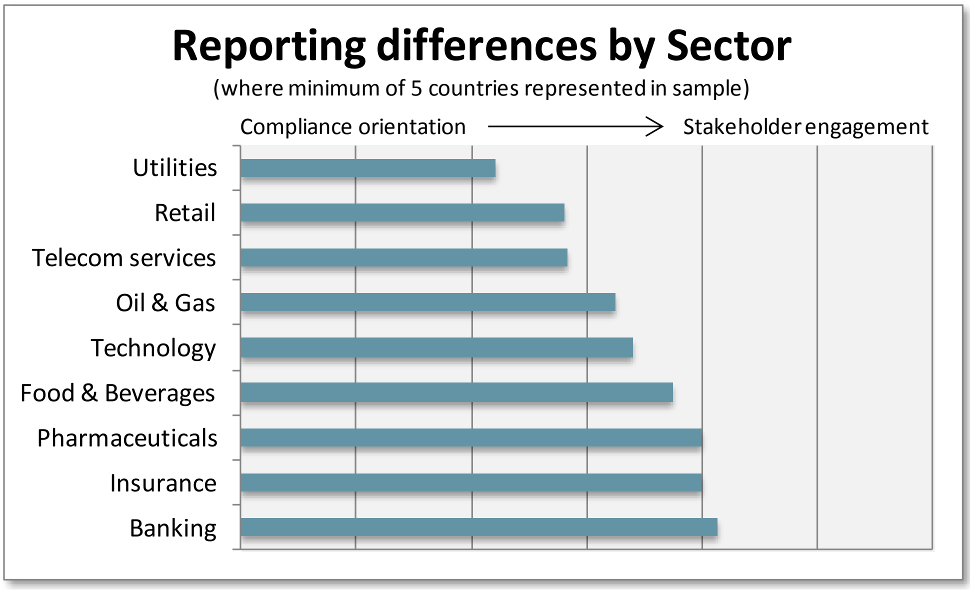
Figure 2: Reporting Differences by Country



Source: HR ValueCurve

Sector continues to act as a strong secondary factor for certain businesses, particularly banking and insurance (see Figure 3). This is not surprising given the high regulatory aftermath and public interest following the financial crisis. While reports from financial services institutions thus tend to rank high in ‘informing’ or ‘engaging’, utility companies are more typically found on the compliance-oriented ‘reporting’ end of the continuum given the more national or regional business.

Figure 3: Reporting Differences by Sector



Source: HR ValueCurve

The survey results showed that several nonfinancial services companies added information on clawback provisions in their 2013 disclosures . This example shows how the requirements for some sectors may influence broader best practice over time.

With technology being a key enabler in supporting effective communication, website investor centers continue to become increasingly sophisticated, offering a variety of choices to interested parties. A number of new features were added by companies in their 2013 disclosures, including different sharing options via social networks.

Outlook

As the 2013 analysis showed, other sectors have started to consider or adopt certain financial services incentive practices or governance improvements, including revisiting performance drivers and vesting schedules. Some financial services disclosure practices may eventually find their way into other sectors; for example, increased information on the compensation of other senior positions or on the relationship between compensation plans and pay levels across organizational hierarchies.

Rising compensation regulation at international levels, the increasing prevalence of global investors, as well as the global sharing and reporting of information, may all contribute toward further convergence in disclosure practice across Europe. It will, however, be interesting to see if there will be comparable moves in the remainder of the developed world and indeed in Brazil, Russia, India and China and other key markets that now provide the major share of global growth.

Conclusion

Finally, and as very effectively demonstrated by some of the shorter reports highlighted in the study, there are various factors to be considered that will either make a compensation report a good report or not. These go significantly beyond the content to be disclosed and include more strategic communication aspects. As the analysis showed, writing a fully comprehensive report that is consistently good is by no means an easy matter. It will likely take several years of effort to improve. This emphasizes that not only is executive remuneration under the microscope, but also any changes to a company's disclosures in this area will not go unnoticed and will send a message. Therefore, any changes to a company's disclosures have to be carefully considered, and must fit with the company's business context and how it wishes to be perceived by its stakeholders.

Author's note: To obtain a copy of the full report, please visit www.hrvaluecurve.com.

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