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New Law on Corporate Governance and Executive Remuneration.

New Law on Corporate Governance and Executive Remuneration - Published.

On 23 April 2010, the new Belgian law of 6 April 2010 enhancing corporate governance in listed companies and autonomous state enterprises was published. The much-debated provisions of the new law make it compulsory to publish in the annual report a corporate governance statement, which must include a specific remuneration report. The new law also requires setting up a remuneration committee. It further regulates senior executives’ severance pay (“golden parachutes”) as well as share-based or other variable remuneration awarded to senior executives and non-executive directors.

1 Background

The financial crisis has put corporate governance and, in particular, executive remuneration back at the heart of discussion. Questions have arisen as to increasing levels of executive remuneration and the incentives created by variable remuneration that may have resulted in excessive risk-taking. The new Belgian law reflects most policymakers’ opinion that, beyond self regulation such as the Corporate Governance Code 2009, binding rules are necessary. It also (partially) implements European directives and recommendations on corporate governance and executive remuneration. In neighbouring countries similar legislative initiatives have been taken to varying degrees.

2 Key provisions

This document considers the key provisions of the new law that apply to Belgian companies having their shares listed on a Belgian or European regulated market. The new rules relating to autonomous state enterprises and individuals who are excluded from acting as directors in the banking and finance sector are not discussed here (we will update you in a separate newsflash on those new rules).
2.1 Corporate governance statement

Listed companies have to insert a corporate governance statement in their annual report. The obligation applies for the first time to the annual report that relates to the current financial year. The statement must form a specific section of the report and at least include the minimum information listed in the new law, such as a reference to the corporate governance code that the company applies and, to the extent that the company does not fully apply such corporate governance code, an indication of the provisions of the code that were not complied with and an explanation of the reasons for non-compliance (comply-or-explain principle). The new law provides that a royal decree may impose a specific corporate governance code as the reference code. It is the intention to have the Corporate Governance Code 2009 serve that purpose.

2.2 Remuneration report

In addition, the corporate governance statement must contain, again as a specific section, a remuneration report. The minimum content of that report is listed in the new law and is predominantly based on European recommendations and principles of the Corporate Governance Code 2009. To that extent, soft law has been turned into hard law. The obligation to draw up a remuneration report is applicable to the financial years starting after 23 April 2010.

The remuneration report must, among others, describe the company’s remuneration policy (including a two-year preview) and provide details on the senior managers’ remuneration packages: (i) on an individual basis for directors (as director) and the CEO and (ii) on a global basis for the management committee members, other senior managers (i.e. members of any committee not being a “formal” management committee in the sense of Article 524bis of the Companies Code but that discusses the management of the company) and persons entrusted with the “daily management” of the company. Moreover, for executive directors, members of a (formal or informal) management committee and persons entrusted with the “daily management” of the company, details on performance based remuneration, share-based remuneration and severance pay must be provided on an individual basis.

The works council, if any, must receive a copy of the remuneration report. The annual shareholders’ meeting must approve the remuneration report by way of a separate vote. According to the preparatory works of the new law, a rejection of the remuneration report by the shareholders’ meeting does not affect, in itself, the annual accounts or existing contractual provisions on remuneration. Such a rejection will, however, be a sign for the board to alter its remuneration policy.
2.3 **Role of the auditor**

The company’s auditor must verify whether the corporate governance statement, including the remuneration report, contains the minimum disclosures imposed by the new law and corresponds with the contents of the related annual accounts. The preparatory works of the new law clarify that an actual qualitative analysis of compliance with the corporate governance code or with the comply-or-explain principle falls outside the auditor’s role.

2.4 **Remuneration committee**

For the financial years starting after 23 April 2010, a remuneration committee must be created which is responsible for, among others, making proposals as to the company’s remuneration policy and drafting the company’s remuneration report. The remuneration committee must exclusively consist of non-executive directors, a majority of whom must be independent. It must have the necessary competence in the sphere of remuneration policies. A limited number of companies are exempted from creating such a remuneration committee.

2.5 **“Golden parachutes” – Variable remuneration to independent director**

Provisions entitling an executive director, a member of a (formal or informal) management committee or a persons entrusted with the “daily management” of the company to severance pay greater than 12 months’ remuneration, or 18 months’ remuneration upon recommendation by the remuneration committee, require prior approval by the annual shareholders’ meeting. The same approval applies to provisions entitling an independent director to any variable remuneration, whatever its amount. Any such provisions that are not approved by the shareholders’ meeting are null and void. Moreover, a prior communication duty exists vis-à-vis the company’s works council, if any, which can make a recommendation (published on the company’s website) to the shareholders’ meeting as to the approval or not of those provisions. These obligations apply to any contracts entered into or prolonged after 3 May 2010.

2.6 **Share-based and other variable remuneration**

If the remuneration policy allows for variable remuneration, any contract entered into with an executive director, member of a (formal or informal) management committee or persons entrusted with the “daily management” of the company must expressly refer to the criteria to be taken into account when determining such variable remuneration. The variable remuneration can only be paid if the criteria were met in the relevant period. In case of non-compliance, the variable remuneration is not taken into account in the severance pay calculation.
The new law is also aimed at companies changing the variable portion of senior managers’ remuneration packages to reflect a more long-term focus. Except where the articles of association provide otherwise or the shareholders’ meeting expressly approves an exception:

- shares cannot vest and options or any other rights to acquire shares cannot be exercised by a director, a member of a (formal or informal) management committee or a person entrusted with the “daily management” of the company within a period of three years after their award; and

- at least 25% of the variable remuneration of the same persons must relate to performance criteria deferred over a minimum period of two years and at least another 25% must relate to performance criteria deferred over a minimum period of three years.

These two “staggering in time” requirements only apply when the variable remuneration constitutes more than one fourth of the annual remuneration package.

All the above obligations on share-based and other variable remuneration apply for the first time to financial years starting after 31 December 2010. The new rules do not affect the tax treatment of share-based and other variable remuneration.

3 First assessment

3.1 Shift from self regulation to binding rules, with a certain degree of flexibility

With the arrival of the new law, a number of recommendations already existing in self regulatory codes of practice, such as the Corporate Governance Code 2009, have now become binding rules. This not only applies to the corporate governance statement but also to the remuneration report. Compared to the Corporate Governance Code 2009, the new law introduces a couple of additional disclosure requirements for such report (including disclosure of a two-year preview on the company’s remuneration policy, details on clawback rights regarding variable remuneration and on all severance pay provisions, and a justification of severance pay paid).

The Corporate Governance Code 2009 already recommended the creation of a remuneration committee. It may be a challenge for certain listed companies to comply with the composition requirement for such committee (non-executive directors only, a majority of whom must be independent). However, it should be noted that, although the tasks and responsibilities of the remuneration committee have been fine-tuned in the law, from a legal point of view such committee remains a mere advisory committee to the board of directors.
The provisions on “golden parachutes” in the new legislation, also inspired by the principles in the Corporate Governance Code 2009, have turned out to be less rigid than proposals on that subject matter in previous draft versions of the law. On this point, flexibility has been built in: if the board of directors is of the opinion that for certain senior executives a higher severance pay is justified, it can submit such proposal to the shareholders’ meeting for approval, possibly after having obtained advice from the works’ council. The works’ council’s advice (a feature introduced in the new law as a result of a political concession) is non-binding but may have – in practice – a dissuading impact.

Deviations from the new “staggering in time” requirements for share-based and variable remuneration are possible as well, provided the articles of association or the shareholders’ meeting authorise such deviations. Therefore, in listed companies with a reference shareholder, these new requirements will presumably have less of an impact than in companies with a wide-spread shareholder base and no reference shareholder. Also, 50% of the variable remuneration of the senior managers’ remuneration package can still relate to performance criteria deferred over a period of less than two years.

3.2 Comparison with legislative initiatives in the UK/US

Compared to the UK, Belgium has gone further to the extent that Belgian legal rules provide not only for disclosure obligations but also for limits on the amount and structure of remuneration. On the other hand, shareholders’ approval of the remuneration report has been a legal requirement in the UK since 2003, although applicable rules make it clear that such vote is of an advisory nature. Experience has shown, however, that shareholders’ rejection of the report (of which there have been a few cases recently) or a strong minority against it leads companies to review critically and sometimes change their remuneration policy. Another point worth noting is the legal requirement that the remuneration committee be composed entirely of independent directors, whereas in Belgium a majority suffices.

Turning to the US, there are also no legal requirements in relation to amount or structure of remuneration, other than (i) the well-publicised rules applying to those companies (listed or not) that have received public funds to bail them out since late 2008 and (ii) new rules applicable to all listed companies in relation to risk management. Under these new rules, any listed company must address its remuneration policies and practices for all employees, including non-executive officers, to determine if such policies create risks likely to have a material adverse effect on the company.
So far, there are no legal requirements as to shareholder approval of remuneration or golden parachutes in the US, but bills have been introduced in Congress to that effect. If adopted, such rules would probably only provide for shareholders’ votes that would not be binding on companies. A number of these bills would also require companies to develop and implement clawback provisions that would (i) be triggered by a financial restatement, (ii) cover all executive officers and (iii) require recovery of all incentive-based compensation from the executive officers for a period preceding the restatement in excess of what they should have been paid under the restatement. If adopted, such rules on clawback would go beyond the new Belgian rules.

More information on this draft law is available from your usual contact person at Linklaters (Belgium). Alternatively, please click here to access the overview of the partners/counsel of the Linklaters (Belgium) corporate department or click here to access the overview of the members of Linklaters’ (Belgium) executive incentive schemes group.

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