REWARD VALUE

SHAREHOLDERS' RIGHTS DIRECTIVE

Background Note

Executive remuneration today is driven by incentives that may no longer align with shareholder interests or reflect broader societal responsibilities.

Reward Value Foundations' mission is to support the development of remuneration policies that contribute to long-term sustainable and inclusive value creation. The Foundation seeks to further the debate on executive remuneration with investors, business schools, and the business community at large to develop evidence-based, long-term, sustainable, and stakeholder-inclusive executive remuneration policies.

Reward Value Foundation is a not-for-profit research initiative. Reward Value can be reached by email (contact@rewardvalue.org). For more information on Reward Value please visit our website www.rewardvalue.org.

Martina Pinti, Caitlin W. Cerqua[1], Frederic Barge

[1] *Corresponding author; contact information: caitlin.walker@rewardvalue.org*

INTRODUCTION

Companies hold an increasingly important position in society. Over the past few years, regulators have become more and more aware of this role and have sought to design policy that incentivises corporate entities towards behaviour that creates value for stakeholders. One important stakeholder is the shareholder, who have a potentially powerful role in steering companies towards these goals.

Already in 2003, the strengthening of shareholder rights had become a central policy concern of the EU in order to facilitate the improvement of company law and promotion of corporate governance.[2] Directive 2007/36/EC, also known as the Shareholder Rights Directive ("SRD"), entered into force on the 3rd of August 2007.

In a 2006 Impact Assessment conducted by the European Commission ("EC") preceding the adoption of the SRD, it was found that the lack of a harmonised framework had resulted in lower shareholder participation across the EU.[3] Shareholders faced difficulties when exercising their voting rights due to issues related to the availability of general meeting notices and related information, as well as practices such as share blocking and cross-border voting.

The Directive's aim was thus to introduce minimum standards for the protection and promotion of shareholder voting rights attached to shares. The provisions address listed companies and aim to foster shareholder engagement, by removing procedural impediments and enhancing the participation tools available to shareholders in the General Meeting.

The evolution of the SRD will be analysed in this background note, with a focus on explaining the Say on Pay provisions introduced by its 2017 amendment.

Section 1 will be dedicated to exploring the legal background of the Shareholders' Rights Directive I and II ("SRD", "SRD II"), as well as the policy options considered at the time of the review. Section 2 analyses in closer detail the provisions of the SRD II relating to Say on Pay. Section 3 provides a brief overview of the implementation of the SRD II in selected member states.

LEGAL BACKGROUND

1.1 Directive 2007/36/EC

The Shareholder Rights Directive was adopted in 2007, with a view to improving shareholder engagement, after it had been recognised that there existed procedural impediments to their participation in the general meeting.

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[2] A Lafarre (2017) "The AGM in Europe: Closing the gap between theory and practice". PhD, Tilburg University.

[3] European Commission (2006). *Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109.EC: Impact Assessment.* p. 8.

The substantive provisions are contained in Chapter II of the legislation, relating to the general meeting of shareholders. In terms of content, a distinction can be drawn between provisions introducing procedural rights and those introducing material rights.[4]

The 2006 Impact Assessment showed that shareholders' participation was often hindered by procedural obstacles, for example in the case of cross-border voting.[5] Certain rights were therefore envisaged with respect to overcoming these hurdles. These are distinct from the remaining rights in the directive, designed to entitle shareholders with broader decisional power in the General Meeting. We will refer to these latter rights as material.

The procedural rights include the obligation for the company to issue the convocation of the general meeting at least 21 days prior to the meeting, as well as the obligation to make all relevant information available to shareholders "for a continuous period beginning not later than on the 21st day before the day of the general meeting and including the day of the meeting" on the company's website.[6] The rationale lies in the need to enable shareholders to cast informed votes by providing them with sufficient time and information to consider their position.[7] Moreover, Article 8 aimed at increasing stakeholder participation by allowing them to attend general meetings remotely through electronic means.[8] The SRD also introduced the right for a shareholder to appoint a proxy holder, that is, a natural or legal person exercising the shareholder's voting right in their absence.[9] Additionally, Article 14 set disclosure requirements with regard to voting results, which shall be made available to the shareholders within a period of 15 days after the general meeting.[10]

The remaining Articles in Chapter II contain material rights, which expand the potential of shareholder engagement by providing shareholders with additional tools to enhance their participation in the General Meeting.

For example, Article 6 granted shareholders the right to place items on the agenda of the general meeting and to table draft resolutions.[11] Companies are free to subject the exercise of this right to a share threshold, which, however, shall not exceed 5% of the company's share capital. The final agenda must in any case be made available in a timely manner to all shareholders: Recital 7 remarks that, in any case, it should be received by all shareholders in "sufficient time to prepare for the discussion and voting on each item".[12] Additionally, the SRD reaffirmed the right of shareholders to ask questions related to the agenda.[13]

Ten years after its adoption, the SRD was amended by Directive 2017/828, or Shareholders' Rights Directive II. The following part of this Section will be dedicated to discussing this amendment, which introduced Say on Pay provisions in EU law.

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[4] A Lafarre (2017).
[5] EC (2006). Impact Assessment. pp9-10.
[6] A Lafarre (2017).
[7] Directive 2007/36/EC of the Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies ("SRD"). Recital 6.
[8] SRD. art 8.
[9] SRD. art 10.
[10] SRD. art 14.
[11] SRD. art 6.
[12] SRD. Recital 7.
[13] SRD. art 9.

1.2 Directive 2017/828

In the aftermath of the financial crisis, it became evident that shareholders played an important role with regard to executives' "short-term risk taking".[14] In particular, it was found that the lack of shareholder engagement and control hampered good decision-making by companies.[15] Moreover, concerns regarding excessive executive pay were brought to the forefront.[16] A further issue that was identified was that of the continued complexities and costs involved in the exercise of shareholder rights.[17]

Accordingly, the Commission started including the promotion of long-term shareholder engagement among its policy goals in corporate governance.[18] The amendments to the pre-crisis framework reflected this stance. In Recital 14 of the SRD II, the Commission recognised shareholders as the "cornerstones of the corporate governance model of listed companies", since they are capable of holding management accountable for their performance, they play a central role in advancing corporate governance.[19] Better governance, in turn, benefits both the company's and the shareholders' interests.[20]

With regard to the first issue, long-term engagement of asset managers and institutional investors was encouraged. Moreover, specific rules introducing a "Say on Pay" ("SOP") mechanism were included, to promote transparency and accountability with regard to executive remuneration. The exercise of shareholder rights was also tackled by the SRD II, through a further facilitation of cross-border voting and a strengthening of the rights themselves. Additionally, a disclosure requirement was introduced for companies with regard to "risky" related party transactions. Since these occur between directors and legal or natural persons that have ties with the company, they can raise suspicions with regards to conflict of interest. Thus, mandatory disclosure is a useful strategy to lessen this risk.

The amendments in the SRD II included direct amendments to the text of the SRD as well as the introduction of several new provisions. Articles 1 and 2 of the SRD, respectively dealing with the scope and definitions, were adjusted in line with the new provisions.

The new provisions were divided into three additional Chapters, with the exception of Articles 9a, 9b and 9c which were added to Chapter II. The new Chapter Ia introduced provisions on identification of shareholders, transmission of information and on the facilitation of the exercise of shareholder rights. [21] Chapter Ib focused on transparency with regard to institutional investors,

[14] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement ("SRD II"). Recital 2.
[15] *Ibidem*.
[16] A Lafarre (2017).
[17] *Ibidem*.
[18] European Commission (2017). *Shareholders' rights directive Q&A*. Available at https://europa.eu/rapid/press-release_MEMO-17-592_en.htm
[19] SRD II. Recital 14.
[20] H Birkmose, K Sergakis (2021), "SRD II: Political Ambitions and Regulatory Rationales", in H Birkmose, K Sergakis "The Shareholder Rights Directive II".
[21] SRD II. Article 1.3.

asset managers and proxy advisors.[22] Articles 9a and 9b incorporated a SOP mechanism into the SRD, which will be discussed in detail in Section 2 of this note.[23] Article 9c introduced a disclosure requirement for related party transactions. Finally, Chapter IIa added two procedural provisions regarding implementing acts and penalties.

The main changes brought by Chapter Ia of the SRD II were: Article 3a, introducing a right for companies to identify their shareholders; Article 3b, which imposed an obligation on shareholders' intermediaries to transmit relevant information to the shareholders; Article 3c, providing for the facilitation of the exercise of shareholder rights. The latter also addressed intermediaries, as the parties entrusted to facilitate the exercise of the rights, by "making the necessary arrangements" or by exercising the shareholders' rights themselves "upon explicit authorisation and instruction of the shareholder and for the shareholder's benefit".[24]

Chapter Ib was centred on transparency of institutional investors, asset managers and proxy advisers. In particular, Article 3g imposed an obligation on institutional investors and asset managers to develop and publish a policy on shareholder engagement in their investment strategy, as well as to disclose how said policy has been implemented. This includes a description of votes cast during the general meeting. The Article employs a "comply-or-explain" mechanism, whereby they are free to choose not to comply as far as a "clear and reasoned explanation" is published.[25]

Articles 3h and 3i relate to specific transparency requirements for institutional investors and asset managers, respectively. Institutional investors are expected to disclose information about their equity investment strategy and any information related to arrangements with asset managers, where investing is carried out through an agreement with the latter.[26] Asset managers in arrangements with institutional investors are also subject to similar requirements: they shall disclose to them how their own investment strategies and the implementation thereof are coherent with and how they contribute to the "long-term performance of the investee company".[27]

Proxy advisors are also subject to transparency obligations, under Article 3j, which include: reporting on their code of conduct[28]; disclosing information linked to the preparation of their

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[22] *Ibidem*.

[23] SRD II. Article 1.4

[24] Consolidated Text: Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies ("Revised SRD"). Article 3c.

[25] Revised SRD. Article 3g.

[26] Revised SRD. Article 3h.

[27] Revised SRD. Article 3i.

[28] Where a code of conduct is not in place, they are expected to explain why it is so.

research, advice and voting recommendations; and identifying and disclosing any conflict of interest.[29]

1.3 Policy options

The Impact Assessment accompanying the 2014 proposal for the adoption of the SRD II presents a detailed overview of six areas of intervention:

- i) increasing the level of engagement of institutional investors and asset managers;
- ii) creating a better link between pay and performance;
- iii) transparency and oversight on related party transactions;
- iv) transparency of proxy advisors;
- v) shareholder identification, transmission of information and instructions by intermediaries;
- vi) improving the quality of corporate governance reporting.

The policy options explored for each of these points varied in form and rigidity.

1. *Engagement of institutional investors and asset managers*

Fostering the engagement of institutional investors and asset managers is instrumental to achieving good decision-making by companies. The favoured option in this case for the Proposal was introducing mandatory rules on transparency of institutional investors and asset managers, enabling creditors, asset owners and asset managers alike to take informed decisions. Opting for mandatory rules in lieu of a recommendation ensures a level playing field through harmonised enforcement and facilitates cross-border investment. It is stressed that only uniform transparency rules are fit to solve the problem of information asymmetry between companies and their shareholders.[30]

2. *Link between pay and performance*

The mismatch between pay and performance was addressed by adopting a mandatory shareholder vote on remuneration, together with transparency measures. In fact, it was concluded that the vote on pay could give shareholders an “effective tool to monitor directors’ remuneration and engage with companies”. This would help align pay and performance.[31]

The results of two public consultations held in 2010 and 2011, respectively totaling 219 and 402 respondents, show that a small majority of respondents agreed with the issuance of a mandatory vote on the remuneration policy and report.[32] Of that majority, most respondents specified that such mandatory vote should be advisory in nature. Only a few respondents ventured to propose a

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[29] Revised SRD. Article 3j.

[30] European Commission (2014) *Proposal for a Directive of the European Parliament and of the Council on amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement: Impact Assessment*. pp. 46-51.

[31] EC (2014). Impact Assessment, pp. 51-57.

[32] EC (2014). Impact Assessment, p. 83.

shareholder vote on individual remuneration.[33] The final decision was to render the vote mandatory but leave the decision to Member States on whether this vote should be binding or advisory.

3. Transparency and oversight on related party transactions

A combination of two options was chosen with regard to related party transactions ("RPTs"): improving transparency requirements for RPTs and introducing a shareholder vote on the most important RPTs. While the combined choice would result in higher costs and administrative burdens for companies, it was deemed able to provide shareholders with timely information related to RPTs. At the same time, it could afford shareholders the right to reject most important RPTs.[34]

4. Transparency of proxy advisors

Mandatory transparency requirements emerged as the most suitable solution. Interestingly, a more stringent/intense option was also considered, regarding the introduction of a detailed regulatory framework. This was discarded, however, due to its disproportionate and possibly even counterproductive character. It was found that, by introducing a Directive with detailed rules, potentially enabling Member States to further legislate, could reduce the attractiveness of proxy advisors' services, by increasing costs and reducing flexibility. Thus, the former option seemed more adequate: it would bind proxy advisors with respect to the methodology and management of potential conflicts of interest, pushing them to put in place adequate procedures. This is particularly relevant as it would promote reliability and accuracy of information in the investment chain.[35]

5. Shareholder identification, transmission of information and instructions by intermediaries

Here, the choice was between defining minimum EU rules and establishing an EU-wide shareholder identification instrument with obligations for intermediaries to transmit information. The latter was the preferred option, as it could "create an efficient and effective mechanism for shareholder identification, ensure efficient and timely transmission of information through the holding chain of intermediaries and facilitate the exercise of shareholder rights".[36] The former option, i.e. introducing mutual recognition of national investor identification systems and promoting existing market standards, would not have fully solved the problem. In fact, the implementation of such market standards tends to be slow and heavily reliant on the existence of a legal basis for the standards. Additionally, the introduction of mutual recognition of national identification systems would not have solved the problem of shareholder identification, since it would not have covered all shareholders. Instead, it would have applied solely to those shareholders in disclosure-friendly jurisdictions.[37]

6. Improving the quality of corporate governance reporting

The most appropriate option was deemed to be the provision of guidelines for the quality of corporate governance reports, in the form of a recommendation. Opting for a soft law solution was regarded as a coherent choice in line with the flexible character of the comply-or-explain approach

[33] EC (2014). Impact Assessment, p.91.
[34] EC (2014). Impact Assessment, pp. 58-62.
[35] EC (2014). Impact Assessment, pp. 62-65.
[36] EC (2014). Impact Assessment, p. 73.
[37] EC (2014). Impact Assessment, pp. 65-73.

usually adopted in corporate governance and allows for greater adaptability to differences in national frameworks. This was preferred to the introduction of detailed requirements on corporate governance reporting: while able to bear a stronger impact due to their binding nature, they would have deprived both the companies and national monitoring bodies of flexibility in adapting the guidelines to, respectively, their individual situation and to national specificities.[38]

In this sense, it must be recalled that, while the EU has broad competence on matters involving company law and thus can adopt directives to harmonize the field, it is still to be considered a shared competence.[39] Indeed, in accordance with the principle of subsidiarity, its intervention is only justified where it would be more effective than national intervention.

ARTICLES 9A AND 9B

2.1 Say on Pay

The relationship between shareholders and directors is a principal-agent one, wherein the directors are tasked with protecting the interests of the shareholders. This type of relationship is characterised by an asymmetry of information: namely, the principal does not possess sufficient information about the agent's behaviour, leading to the risk of moral hazard.[40]This dynamic justifies, in theory, the adoption of executive remuneration practices based on performance, which have been traditionally identified as a solution capable of lowering agency costs by aligning the incentives of executives with the interests of shareholders.[41] However, incentive pay has been criticised as problematic itself, due to opportunistic managerial behaviour further deepening the agency problem, rather than solving it.[42]

"Say on Pay", which purports to afford shareholders the right to vote on executive remuneration, emerged as an alternative to pre-existing remuneration practice. The introduction of a SOP mechanism can, in theory, offer a solution to the agency problem: on one hand, by enhancing the dialogue between shareholders and executives; on the other, by exerting shareholder pressure on executive boards to reduce excessive compensation levels.[43] In practice, studies have shown that executive pay levels are not among the factors affected by SOP mechanisms: rather, negative remuneration voting outcomes bear impacts on elements such as the remuneration structure[44], remuneration policies and contracts[45], disclosures on remuneration[46] and firm productivity.

[38] EC (2014). Impact Assessment, pp. 73-76.
[39] Treaty on the Functioning of the European Union. Article 50 (2)(g).
[40] A Lafarre (2017).
[41] C Van Der Elst, A Lafarre (2021), "Article 9a and 9b: say on pay", in H Birkmose, K Sergakis "The Shareholder Rights Directive II".
[42] *Ibidem*.
[43] C Van Der Elst, A Lafarre (2021). p255.
[44] N Burns & K Minnick (2013) "Does Say-on-Pay Matter? Evidence from Say-on-Pay Proposals in the United States". The Financial Review. 48. pp 233-258.
[45] F Ferri & D A Maber (2013). "Say on Pay Votes and CEO Compensation: Evidence from the UK". Review of Finance. pp 527-563
[46] M Grosse et al. (2015). "Shareholder say on pay and CEO compensation: three strikes and the board is out". Accounting & Finance. 57(3). pp 701-725.

SOP has been widely embraced by national jurisdictions in and outside of Europe in recent years. While the emergence of SOP discourse can be traced back to the United States ("US"), the first piece of legislation incorporating the right of shareholders to vote on executive remuneration was enacted by the United Kingdom ("UK") in 2002.[47] The Dutch legislator followed suit by introducing the principle in its own jurisdiction in 2003; similarly, the Australian legislator provided for an advisory vote in 2004.[48]

SOP finally made its entrance in EU law during the revision process of the SRD. The European Commission made it clear that "The structure of director's remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance".[49] Accordingly, the text of the revised SRD introduced Articles 9a and 9b, providing for shareholders' right to vote on the remuneration policy and the remuneration report.

The remuneration policy is an internal document containing a detailed explanation of remuneration components and performance indicators. The remuneration report is a (yearly) account of the compensation paid. Each of these documents constitute a separate voting item for shareholders under SRD II.

2.2 Article 9a: Say on Pay on the Remuneration Policy

Article 9a provides for the establishment of shareholders' right to vote on the remuneration policy.[50] A remuneration policy provides information on the remuneration practices within a company or organisation. It describes the details of each remuneration component, the performance indicators linked to the remuneration envisaged, as well as any other information prescribed by law or the articles of association.[51] The text specifies that the right to vote is limited to directors' remuneration policies; in this sense, Article 2 broadly defines directors as "any member of the administrative, management or supervisory bodies of a company ", in general pointing to high-level executive officers of the company.

Companies must put in place an executive remuneration policy and shareholders shall be able to vote on it during the general meeting. The final text of the SRD II allows Member States discretion on whether to implement a binding vote or an advisory one. Notably, a company may not choose to implement a binding vote where its national legislator opted for an advisory one.

Additionally, it must be remarked that the choice between advisory and binding merely relates to the nature of the outcome of the vote; in any case, Member States must ensure that the vote takes

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[47] The Directors' Remuneration Report Regulations, 2002. Accessible at https://www.legislation.gov.uk/uksi/2002/1986/contents/made

[48] For more information on the history of Say on Pay, see our report on Say on Pay commissioned by Eumedion, available at https://www.rewardvalue.org/wp-content/uploads/2023/04/February-Report-Eumedion_RV.pdf.

[49] European Commission (2009). *Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies*. para 6.

[50] Revised SRD. Article 9a.

[51] Human Resources Management Handbook (n.d.) "Compensation Policy". HRM Handbook. Accessible at https://hrmhandbook.com/hrp/compensation/policy/.

place during the general meeting. As posited by Lafarre and Van der Elst, while the result of the vote can be non-binding, its organisation is mandatory.[52]

Where a Member State provides for binding shareholder voting, executive remuneration may only be paid out by the company if the remuneration policy has been approved. The minimum threshold set by the SRD II is a simple majority of the shareholders participating in the general meeting. Member States may, however, choose to establish a more stringent threshold.

If the vote is binding and the remuneration policy does not satisfy the threshold for approval, it will be rejected. In that case, the company is obliged to revise the policy and submit it to the subsequent general meeting; the company may not submit an unaltered version of the rejected policy. Until the remuneration policy is approved, the previous remuneration policy will be applied. Where no previous policy is in place, the text allows for previous remuneration practices to remain applicable. While the text is not specific about the definition of said practices, it is made clear that, eventually, a remuneration policy must be adopted for the company to comply with the SRD II.

When a Member State opts for the advisory vote, any remuneration policy submitted by the company to the general meeting will be applied, regardless of the outcome of the vote. If a policy does not meet the threshold, it will nonetheless be used to determine executive pay, but the company must still submit a revised version to the following general meeting. The company must also make the policy available, including the date and results of the vote, by publishing it without delay on its website. The remuneration policy, date and results of the vote shall remain public and available free of charge on the website for the entire validity of the policy, at a minimum. [53]

Finally, Article 9a(5) sets out the duty to subject the remuneration policy to a vote every four years, or at every material change.[54] No guidelines were provided with regard to what constitutes a material change, rather it must be assessed on a case-by-case basis. Companies have considered instances such as increases in executives' maximum earning opportunity in long-term and short-term incentives as material changes to the policy.[55] Another material change considered, among others, was the introduction of a pre-defined list of performance criteria for short-term incentives.[56]

2.3 Article 9b: Say on Pay on the Remuneration Report

Article 9b establishes an obligation for companies to draw up and publish an executive remuneration report. The report shall comply with several content requirements regarding "each individual director's remuneration".[57] Information must be provided with respect to, for example, the total amount of remuneration, including an explanation of how it complies with the remuneration policy and the company's long-term performance. The report must also include the

[52] C Van Der Elst, A Lafarre (2021).
[53] Revised SRD. Article 9a(7.
[54] Revised SRD. Article 9a(5).
[55] Huthamaki (2023). "Amended Remuneration Policy for the Governing Bodies". *Huthamaki*. Available at https://www.huhtamaki.com/globalassets/global/investors/corporate-governance/agm/agm-2023/march-29-update/en/amended-remuneration-policy-for-the-governing-bodies.pdf
[56]ASM International NV (2023). "Remuneration Policy". *ASM International*. Available at https://www.asm.com/media/1yjge02g/remuneration-policy-management-board.pdf
[57] Revised SRD. Article 9b(1).

annual change of remuneration, of company performance and of average remuneration of non-executive employees; these three elements shall be "presented [...] in a manner which permits comparison".[58] Another aspect that must be specified in the report is the number of shares and share options offered to executives, together with an explanation of the conditions for the exercise of related rights.

Additionally, shareholders must be granted a right to cast an advisory vote on the report during the general meeting. In this case, when the shareholders reject the report, the company does not need to resubmit a revised version thereof. However, it must explain how it took the results of the vote into account when drafting the following remuneration report. Interestingly, as will be explored in Section 3, Member States may elevate this vote to a binding vote, whereupon the consequences of the negative vote will be more severe.

The vote on the remuneration report differs from the one on the remuneration policy because Member States' legislation must ensure it is cast every year. Notably, the text allows SMEs to forego the organisation of the vote altogether by substituting it with a discussion with shareholders. The results of the discussion must be nonetheless taken into account in the next report.

Finally, it must be noted that, while Article 9a provides for ex ante shareholder inference, Article 9b works ex post. On one hand, with regards to the remuneration policy, shareholder engagement is increased and shareholders can effectively have a say on its content prior to its adoption. On the other hand, as far as the remuneration report is concerned, a negative vote by shareholders does not prevent the adoption thereof, except where Member States have adopted a more stringent approach.

NATIONAL IMPLEMENTATION OF SAY-ON-PAY

The Shareholders' Rights Directive II came into force in September 2020, with the deadline for transposition in Member States on June 10th, 2019. The SRD II's Implementing Regulation 2018/1212, which sets minimum requirements for a harmonised transposition of the Directive, also came into force in September 2020 in all Member States.

The "say on pay" mechanism of the SRD II is arguably its most important novelty. This note will now explore how this instrument has been implemented in national legislation across selected Member States.

The focus will be on four national implementations of the Directive, showcasing different levels of stringency with respect to the choice between advisory and binding voting outcome. The Member States considered showcase different intensities: ranging from France's comprehensive interpretation to Austria's softer approach, with the Dutch and German frameworks falling somewhere in between on the spectrum.

1. *France*

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[58] Revised SRD. Art. 9b(1)(b).

The French legislator offers arguably the strictest implementation of the SRD II, further strengthening France's approach vis-à-vis SOP. Before the transposition, the national regime already envisaged shareholder voting on the remuneration policy and report. SOP on these two items was introduced in 2013 and 2017, respectively.[59]

In the aftermath of the SRD II, French corporate governance became the most stringent in Europe in terms of shareholders' rights in relation to remuneration. In fact, the *Loi Sapin 2* exceeded the requirements of the European Directive, by establishing a binding outcome annual vote on both the remuneration policy and report.[60]

On the one hand, it provides for an *ex-ante* vote on the principles and criteria employed to calculate, divide up and award the elements of executive remuneration. If the result of the vote is negative, the principles and criteria adopted previously stand; if there were no approved principles and criteria before the vote, the determination of executive pay shall be carried out according to the previous year or existing company practice.

On the other hand, the *Loi* establishes an *ex-post* vote on individual directors' remuneration, encompassing all the remuneration elements and benefits paid out in the previous financial year. In case of a negative shareholder vote, the variable and exceptional pay items are suspended.

It is relevant to consider the French approach regarding the remuneration report in comparison to the SRD II. As illustrated above, the latter only requires an advisory vote and even creates a carve-out for SMEs. In any case, the vote on remuneration mandated by the SRD II must be carried out at least every four years. In contrast, the *Loi* expects companies to set up an annual vote, whose results shall be binding.

2. The Netherlands

Prior to the adoption of the *Wet tot implementatie van de Herziene aandeelhoudersrechtenrichtlijn* ("the Act"), which entered into force on December 1st, 2019, SOP was already present in Dutch Corporate Governance. Indeed, the Dutch Civil Code provided for a binding vote on remuneration back in 2004, to be carried out at any material change of the remuneration policy or where a new remuneration policy was drafted.[61] Thus, no *routine* vote was required.

Following the entering into force of the Act, the requirements regarding SOP acquired more specificity in compliance with the SRD II. First of all, the ex-ante binding vote on the remuneration policy must be cast at least every four years and the threshold for adoption is set at 75% of the votes cast at the AGM.[62] Furthermore, the Act introduces an annual, ex post advisory vote on the remuneration report. Finally, companies are expected to comply with certain disclosure requirements, meant to explain how "social acceptance" and workers' council advice were taken into account during the drafting of the remuneration policy. Notably, the Dutch legislator also

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[59] LOI n° 2016-1691 du 9 décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique ; LOI n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises.

[60] Code de Commerce. L22-10-8; L22-10-9; L22-10-34(I)

[61] Burgerlijk Wetboek. Boek 2. Article 135.

[62] Burgerlijk Wetboek. Article 135a.2.

afforded SMEs the exception envisaged by the SRD II, which allows these companies to forego the shareholder vote in favour of an informal discussion.

3. Germany

The German legal system already encompassed a SOP mechanism. Indeed, an optional, advisory vote on executive remuneration was afforded to shareholders of listed companies since 2009. In 2013, the vote was rendered mandatory, through the introduction of Section 120(4) of the German Stock Corporation Act.

In accordance with the European Directive, the German legislator adopted the *Gesetz zur Umsetzung der zweiten Aktionärsrechterichtlinie* ("ARUG II"). Section 120a of the ARUG II empowers the general meeting of listed companies with the right to establish a remuneration "system" (policy) of both the executive board and supervisory board members.[63] In the case of a rejected remuneration policy, a resolution must be tabled (at the latest) in the next ordinary general meeting, proposing a new policy. However, the vote remains advisory in nature and there are no direct consequences on the remuneration as such. Section 120a (4) envisages the shareholders' vote on the current year's remuneration report, as well as the audited remuneration report of the preceding year. This vote is also advisory in nature, prescribing no specific consequences for a negative opinion by the shareholders.[64]Indeed, the German law specifies that these shareholder resolutions create "neither rights nor obligations".[65]

As per the Dutch implementation, the German Act also introduced the voting exception for SMEs.

4. Austria

Unlike the previously considered jurisdictions, Austria did not have SOP rules in its national law prior to the implementation of the SRDII. Its implementation of the SRD II is therefore interesting to consider.

The Austrian legislator issued the *Aktienrechtsänderungsgesetz 2019*, which effectively introduces shareholder voting on the remuneration policy and remuneration report.[66] Prior to this, the Austrian Corporate Governance Code only envisaged such a vote in the general meeting when stock option schemes and stock transfer programmes of executive board members were to be approved.

Both in the case of the remuneration policy and report, the results of shareholders' vote are not binding; what is mandatory is the organisation of the vote. This is the minimum requirement set by the SRD II, making the Austrian legislator's approach clearly more lenient than its French counterpart. Accordingly, where the remuneration policy is not approved by the shareholders, it shall nonetheless be applied. However, a revised version of the policy must be submitted to the subsequent general meeting.

[63] Gesetz zur Umsetzung der szweiten Aktionärsrechterichtlinie ("ARUG II"). Section 120a(1).
[64] ARUG II. Section 120a(4).
[65] ARUG II. Section 120a(1).
[66] Aktienrechtsänderungsgesetz 2019 – BGBl I 2019/63.

The similarity between the German and Austrian implementation of the SRD II is notably due to their both falling under the Germanic Law family, which, like other parts of Continental Europe, is rooted in Roman Law.

CONCLUSION

The present background note analysed the EU rules governing shareholder engagement in corporate governance, with a view to expounding the influence of "Say on Pay" on their development.

Shareholder engagement in EU corporate governance was initially encouraged through the adoption of the SRD, which introduced shareholder rights aimed at reducing procedural restraints as well as empowering shareholders with positive rights to effectively participate to General Meetings. The former focused on removing procedural hurdles, for example by enabling proxy voting and participation to the meetings at a distance; the latter complemented and enhanced shareholders' right to vote, by granting them the right to put items on the agenda and ask questions.

In the aftermath of the financial crisis, it was found that there was a strong need for long-term investor involvement against the short-term attitudes of executives. As a result, the pre-existent EU Directive establishing shareholder rights was amended to include a SOP mechanism, as well as an improvement of procedural rights. Adopting said SOP mechanism, comprised of an *ex-ante* vote on the remuneration policy and an *ex-post* vote on the remuneration report, was rendered mandatory for EU listed companies. However, the choice of its nature, that is, a binding or advisory vote, was left to the discretion of Member States.

As it turns out, different national jurisdictions adopted different levels of stringency when implementing the revised SRD. The most stringent implementation was that of the French legislator, who established a binding vote on both the remuneration report and policy. Other Member States opted for a lighter approach, as was the case with Germany and the Netherlands, providing for a binding vote on the policy and an advisory vote on the report. Austria, one of the Member States with no pre-existing SOP rules, went with a light-touch implementation which entails that both the vote on the policy and on the report are advisory in nature.

At the time of writing this note, discussions for further amendments to the SRD framework are being had. It remains to be seen how the current text will be amended by a future SRD III; however, some reports by entities such as ESMA cast light on the continued issues shareholders experience when attempting to exercise their rights, especially in cross-border interactions. Our report for Eumedion in January of this year also shed light on broader systemic issues in the engagement between shareholder and companies. For more information on this and other domains of revision, see our upcoming Policy Brief.

Note on citations:

In addition to referring to Directive 2007/36/EC as “SRD” and to Directive 2017/828 as “SRD II”, reference is made to articles belonging to the “Revised SRD”, indicating the consolidated version of the SRD after the entry into force of the SRD II.

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