Instruments of EU Corporate Governance

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Editor

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Introduction

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Edited by

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CHAPTER 9

Remuneration and Shareholdings of Directors

Christoph Van der Elst

Directors' pay is a pivotal issue in corporate governance. Even before corporate governance became a fashionable topic in the 1990s, remuneration was on the research agenda of companies, academics, and policy makers, and it stayed ever after. In the first part of this chapter, I address how remuneration is being used as an instrument of corporate governance during the different waves of interests in directors' pay. In the pre-corporate governance era, compensation was embedded in the managerialist governance approach of companies: management followed a stakeholder interest approach, and pay was largely tied to supply and demand of managerial services and expertise of running large companies. Later in the twentieth century, the shareholder wealth maximization perspective took root and compensation packages were used as an instrument for increasing shareholder wealth. Corporate governance codes largely supported this approach. Due to managerial power, directors' pay continued to increase and the say-on-pay mechanism must now mitigate exaggerated compensation. In the meantime, compensation is more frequently being used as an instrument to tie pay to sustainability goals.

An important component of directors' pay are shares of the company. Most executive directors' remuneration contracts do contain long-term incentive schemes, which include (options on) (restricted) shares in many different forms and colours according to the jurisdiction preferences, industry characteristics, company specificities, and executive director's requests. All corporate governance codes contain many detailed and lengthy provisions on how the remuneration package with bonuses, long-term incentive schemes, and shareholdings of executive directors should be structured. However, little is known of the recommendations for non-executive directors of acquiring and holding shares in the company and the related corporate practices. In the second part of this chapter, I address this issue. The first section studies the legal framework of the director as a shareholder. Next, the best practices of the compensation of the non-executive directors in different corporate governance codes are investigated. The third section analyses the practices of acquiring and holding shares of non-executive directors in four jurisdictions of which the corporate governance code different provisions for the remuneration of non-executive directors. The last part of the chapter provides in a conclusion.

§9.01 DIRECTORS' COMPENSATION AS A GOVERNANCE INSTRUMENT

[A] Compensation in the Pre-corporate Governance Era: From Managerialism to Shareholder Wealth

'The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own'.[1] This famous quote of Adam Smith illustrates the agency conflict between the board of directors of a company and its shareholders. Directors of companies hold the residual rights of control and are expected to possess more expertise than the shareholders. However, it can also result in inefficient director-enriching actions which lowers the return of the company. One mechanism overcoming this agency problem is incentivizing contracts inducing the directors to act in the interest of the company. During the era of the principal-agency theory preceding the corporate governance heydays, compensation policies had to give directors the incentives to select and execute corporate strategies that pursued long-term growth of the company.

Overall and as far as compensation data are available, companies practiced a *bonus* to well-performing executive directors aligning the interests of the involved parties. Murphy showed that when larger companies emerged in the early days of the twentieth century, there was a shift from owner-managers to managerial directors without equity stakes for which alternative remuneration schedules were developed with bonuses tied to company revenues.[2] The data support the thesis that the interest of the company included the interest of different stakeholder groups, on equal footing.[3] 'Stockholders have no special priority; they are entitled to a fair return on their investment, but profits above a "fair" level are an economic sin'.[4] Consequently, compensation packages had to take into account the skills and expertise of the managers running the ever-increasing companies rather than shareholder wealth

1. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 310 (T. Nelson and Sons, London 1852).
2. Kevin Murphy, *Executive Compensation: Where We Are, and How We Got There*, in *Handbook of Economics of Finance* 250 (George M. Constantinides, Milton Harris, Rene M. Stulz eds., Elsevier 2013).
3. An extensive overview of the developments from managerialism towards shareholder wealth maximization can be found in James Park, *From Managers to Markets: Valuation and Shareholder Wealth Maximization*, 47 J. Corp. L. 2, 435–484 (2022).
4. Wilbert Moore, *The Conduct of the Corporation* 9 (Random House, 1962).

maximization. Since the 1930s, information on executive pay had to be disclosed and more studies were investigating the relationship between corporate performance and executive pay. It led to the finding that the pay-to-performance remained similar from the 1930s to the 1980s.[5] Even more remarkable, Frydman and Saks showed that the sensitivity of changes in wealth to corporate performance was stable since the 1950s to the 1980s with a plunge in the 1970s.

In the 1980s, performance related pay became the economic talk of the town and the shareholder wealth maximization idea took root. However, using compensation for the alignment between the interests of directors and management and shareholder wealth was encountering many hurdles. Various reports showed that the size of the company, often measured by sales was the dominant criterion affecting executive compensation, questioning the effects of corporate performance. Murphy was among the first to criticize these views as he successfully argued that the studies omitted important parts of the pay package including stock options, deferred compensation, and stock awards and ignored the performance effects of the different parts of the remuneration package.[6] Nevertheless, making use of remuneration data stretching over the 1960s to the early 1980s and the shareholder returns, he confirmed that sales growth is an important determinant of executive compensation. Testing the self-serving management hypothesis, whereby managers were maximizing their own welfare which would be opposite to the interest of the shareholders, Benston studied the effects of shareholder returns and wealth effects of executive directors in conglomerates.[7] He noted that while the relative holdings of directors in those companies is very limited, the effects of shareholder returns can be considerable. Benston argued that the widespread belief in the self-serving management hypothesis should be taken with much caution and that the (direct and indirect) shareholdings induce directors to act in the interest of the shareholders. Jensen and Murphy expanded the studies of Murphy and Benston with an empirical assessment of both the incentives of the compensation packages in the contract with the chief executive officer (CEO) as well as the effects of stock ownership of CEO's.[8] The study confirms Bentson's findings of the performance incentives that come from ownership of shares. All their indicators show that the sensitivity of the compensation to the shareholder wealth is decreasing. Pay-performance sensitivity was nine times higher in the 1930s compared to the 1970s to mid-1980s. Importantly, the study shows that remuneration was already an important corporate governance (alignment) instrument before it became embedded in the corporate governance discussion.

5. Carola Frydman and Raven Saks, *Executive Compensation: A New View from a Long-Term Perspective, 1936–2005*, 23 Rev. Financ. Stud. 5, 2100 (2010).
6. Kevin Murphy, *Corporate Performance and Managerial Remuneration – An Empirical Analysis*, 7 J. Account. Econ., 11–42 (1985).
7. George Benston, *The Self-Serving Management Hypothesis – Some Evidence*, 7 J. Account. Econ., 67–84 (1985).
8. Michael Jensen and Kevin Murphy, *Performance Pay and Top-Management Incentives*, 98 J. Political Econ. 2, 225–64 (1990).

[B] Compensation in the Early Corporate Governance Days: Pay for Shareholder Return

In the 1990s and (only) after the publication of the first corporate governance codes, director compensation became to be seen as a pivotal instrument of good corporate governance. The first corporate governance code, the Cadbury Code was hesitant in identifying compensation as a corporate governance instrument when emphasizing appropriate disclosure of the remuneration packages and referring to the shareholders' requests 'that the remuneration of directors should be both fair and competitive'.[9] Similarly, in the first Dutch and French corporate governance codes, compensation was not immediately addressed as a corporate governance instrument. The Dutch 1997 Peters report referred to an employee stock option plan strengthening the 'involvement in the company over the long term', but it did not specify that these plans must be considered, while the French Vienot I report stressed only that the remuneration committee can be charged with providing recommendations of the remuneration levels and occasionally stock option plans.[10] The focus lied on the role, composition, and functioning of the board of directors.

After a hesitant start, all codes soon considered compensation as an ideal instrument for the *alignment of the interests of directors and shareholders*. The 1995 United Kingdom (UK) Greenbury Code reads in Best Practice C4: 'The performance related elements of remuneration should be designed to align the interests of Directors and shareholders and to give Directors keen incentives to perform at the highest levels.' The Greenbury Best Practices C5 and C6 empower the remuneration committee to consider the eligibility of the director for an annual bonus and a long-term incentive scheme. For executive directors, a common remuneration package includes, according to section 6.14 of the Greenbury Code, a basic salary, benefits in kind, annual bonus, share options, other long-term incentive schemes, and pension rights. The Greenbury Committee considered an annual bonus as a valuable instrument of management, reflecting company performance against targets. The Committee was flexible vis-à-vis long-term incentive schemes with options of which the exercise price could be set at the share price of the granting date or up to 15% below.[11] These schemes 'give Directors a personal financial interest in seeing the share price rise, thus helping to align the interests of Directors and shareholders. In principle, they enable Directors to build up holdings of shares in the company.'[12] Rewarding directors with a predetermined number of shares depending on 'challenging performance criteria' are considered a valuable alternative. All directors should be encouraged to acquire and retain significant shareholding in the company for enforcing the alignment of the interests of both

9. The Committee on the Financial Aspects of Corporate Governance, *Report*, 4.44 (GEE December 1992).
10. Committee on Corporate Governance, *Recommendations on Corporate Governance in the Netherlands*, 4.6 (Amsterdam, 1997); C.N.P.F. and A.F.E.P, *The Boards of Directors of Listed Companies in France*, 20 (Paris, 10 July 1995).
11. Study Group chaired by Sir Richard Greenbury, *Directors' Remuneration*, 6.24 (GEE 17 July 1995).
12. *Ibid.*, 6.27.

directors and shareholders.[13] Similarly, the Dutch Tabaksblat Code of 2003 acknowledged the remuneration of the management board as an important corporate governance instrument, although recognizing next to the 'share price performance' also its relationship with the interests of the company:

> The remuneration structure, including severance pay, is such that it promotes the interests of the company in the medium and long term, does not encourage management board members to act in their own interests and neglect the interests of the company and does not 'reward' failing board members upon termination of their employment. The level and structure of remuneration shall be determined in the light of, among other things, the results, the share price performance and other developments relevant to the company.[14]

In the United States (US), compensation and especially stock options were considered the pivotal instruments for increasing firm value. Share option plans were common practice, and consequently CEOs pay tripled in the 1990s due to the explosion in the use of stock options. Since the mid-90s, stock options became the single largest compensation component of CEOs of S&P 500 firms and by the end of the decade those options accounted for more than half of the compensation.[15] Also, and as a result, the (executive) directors were significant shareholders in the company. Overall, the contingency of CEO-compensation on the achievement of performance goals is common practice. A study of Bebchuk and Tallarita showed that in 2021 the mean part of the performance related compensation of the S&P 100 companies CEOs exceeds 85%, the median being 91%.[16]

[C] Compensation as an Imperfect Corporate Governance Instrument: Managerial Power and Risk-Taking

Noticing these continuously increasing pay packages, Bebchuk and Fried argued in the early years of the new millennium that these compensation packages are to be considered as part of the agency conflict.[17] These scholars show the managerial influence of the remuneration package in the direction of favouring the executive director. The introduction of equity-based compensation did not replace the cash compensation. Executive directors received pay increases in option plans, which were, at best, only partially a result of the directors' own performance. Market and sector trends influenced executive pay, and directors could easily reap those windfalls. Pay

13. *Ibid*. 6.41.
14. Corporate Governance Committee, *The Dutch Corporate Governance Code*, Principle II.2 Remuneration (Amsterdam, December 2003).
15. Murphy, *Supra* n. 2, 274–5.
16. Five companies do not provide performance related pay, all others offer more than two-third of the total compensation as performance-based compensation. Lucian Bebchuk and Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 48 J. Corp. L., Forthcoming (2022).
17. Lucian Bebchuk and Jesse Fried, *Executive Compensation as an Agency Problem*, 17 J. Econ. Perspect. 3, 71–92 (2003); and Lucian Bebchuk and Jesse Fried, *Pay Without Performance* (Harvard University Press, Cambridge 2004).

consultants helped to structure the compensation packages in the advantage of the newly hired executive directors. Research showed that practices of vesting terms of three to five years for the equity component did not filter the 'luck' component, and adequate refining the impact of macro-economic factors in compensation packages is advisable.[18]

Later in the first decade of the new millennium, the role of risk in compensation packages became a hotly debated issue. Especially in financial institutions, the remuneration packages were seen as one of the contributors of the financial crisis at the end of the first decade.[19] Bonuses of directors and other key personnel of (large) (financial) institutions were designed to enhance risk-taking behaviour. The Financial Stability Board issued standards addressing a pay package that incorporates the risk exposure of the firm.[20] Thereto a significant portion of the compensation should be variable, substantially deferred for at least three years and in the event of negative contributions, the unvested portions should be clawed back. The risk component was acknowledged in the European Capital Requirements Directive III.[21] The remuneration policy of the financial institution must address:

> The measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required. The allocation of the variable remuneration components within the credit institution shall also take into account all types of current and future risks.[22]

In the meantime, claw back provisions, especially when the company needs to file a restatement, became common practice in the US compensation practice.[23]

18. Lars Oxelheim, Clas Wihlborg, and Jianhua Zhang, *How to Avoid Compensating the CEO for Luck: The Case of Macroeconomic Fluctuations* in *Research Handbook on Executive Pay*, 159–182 (Randall Thomas and Jennifer Hill eds., Edward Elgar, Cheltenham 2015).
19. European Commission, Green Paper – Corporate Governance in Financial Institutions and Remuneration Policies, 11 (Brussels, COM2010 284 Final, 2 June 2010). David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities – Final Recommendations* (London, 26 November 2009).
20. Financial Stability Board, *FSB Principles for Sound Compensation Practices*, 3 (Basel, 25 September 2009).
21. Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies, OJ L 329, 14.12.2010. This Directive is abolished but similar requirements are to be found in article 94 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176 27.6.2013.
22. *See* Art. 94 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176 27.6.2013.
23. Shearman and Sterling, *Corporate Governance & Executive Compensation Survey 2021*, 59–62 (Shearman & Sterling LLP 2021).

[D] Say on Pay and Remuneration Policies: Shareholders Holding the Reins of Remuneration

At the start of the corporate governance era, a participative role of the shareholders in executive directors' compensation packages was not considered as best practice. The Cadbury Code stated explicit:

> The Committee has received proposals for giving shareholders the opportunity to determine matters such as directors' pay at general meetings but does not see how these suggestions could be made workable. 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.[24]

However, soon afterwards, the involvement of the shareholders became a leading best practice. Already in 2002, the UK introduced a mandatory non-binding say-on-pay vote through the Directors' Remuneration Report (DRR) Regulations 2002.[25] The European response followed soon with the 2003 *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*. The European Commission considered the participation of the shareholders key in the issuance of share and share option schemes.[26] Only one year later, the Commission's recommendation added that a 'remuneration statement should be submitted to the annual general meeting of shareholders for a vote'.[27] The example of the UK regulations woke up many jurisdictions that started experimenting with many different forms of say-on-pay systems. In the Netherlands, the Dutch legislator introduced in 2004 a division of powers for remuneration policy and the remuneration packages. The remuneration policy of listed Dutch companies must always be adopted by the general meeting of shareholders. It is common practice that the supervisory board in a two-tier board structure is empowered to determine this individual remuneration package of the executive board members.[28]

24. The Committee on the Financial Aspects of Corporate Governance, *Report*, 4.43 (GEE December 1992).
25. The original version of the regulation can be found (21 March 2022), https://www.legislation.gov.uk/uksi/2002/1986/regulation/3/made.
26. European Commission, *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward* (Brussels, COM (2003) 284 final, 21 May 2003).
27. Art. 4.2 of Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies OJ L 385 29.12.2004. In 2007 a study of the European Commission found that only a few Member States followed the recommendation of the European Commission of providing a shareholder vote on the remuneration policy (Commission Staff, *Report on the Application by Member States of the EU of the Commission Recommendation on Directors' Remuneration*, SEC(2007) 1022 (Brussels, 13 July 2007)). The European Commission confirmed its viewpoints in 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, OJ L 120, 15.5.2009, 28.
28. Christoph Van der Elst and Anne Lafarre, *Shareholder Voice on Executive Pay: A Decade of Dutch Say on Pay*, 18 European Business Organization Law Review, 56–58 (2017).

In the US Advisory, Say on Pay for top executives' compensation was embedded in corporate life by section 951 of the Dodd-Frank Act.[29] According to the SEC's final rule related to this section, a separate shareholder advisory vote must be provided to the shareholders for approving the compensation of the CEO, the chief financial officer (CFO), and the three most highly compensated executive officers other than the CEO and CFO. Further, shareholders of American companies also regularly vote on the frequency of the say-on-pay vote.

Many other countries introduced other kinds of a say-on-pay vote.[30] Australian companies make use of the two-strike rule. Shareholders of listed companies can 'spill the board' if the company remuneration report receives a negative reception at two consecutive annual general meetings (AGMs) of more than 25% of the votes. The company must organize another general meeting with an agenda containing a resolution to hold fresh elections for directors, not being the managing director.[31]

The European Union (EU) harmonized the say-on-pay system in the Member States in the Shareholder Rights Directive II (SRD II). Shareholders should be offered a binding vote on the remuneration policy at least every four years and a yearly advisory vote on the remuneration report.[32] The SRD II provides guidelines as to the content of the remuneration policy and the remuneration report. Currently, there is mixed evidence as to the effects of these say-on-pay votes.[33]

Another mechanism in the 'fight' against badly composed pay packages,[34] next to the say on pay and accompanying say on pay in the US, is the ratio of the total

29. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, H.R. 4173 (July 2010) (the 'Dodd-Frank Act'). Randall Thomas and Christoph Van der Elst, *Say on Pay Around the World*, 92 Washington University Law Review 671–673 (2015).
30. *See* for an overview Christoph Van der Elst, *Shareholder Engagement and Corporate Voting in Action: The Comparative Perspective* in *Shareholder Engagement and Voting*, forthcoming (Harpreet Kaur, Chao Xi, Christoph Van der Elst, and Anne Lafarre eds., Cambridge University Press 2022).
31. Art. 250V Australian Companies Act.
32. There are exceptions possible, like an advisory vote for the remuneration policy. Article 9b and 9a of 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, OJ L 132, 20.5.2017. Christoph Van der Elst and Anne Lafarre, *Article 9a and 9b: Say on Pay*, in *The Shareholder Rights Directive II: A Commentary*, 250–284 (Hanne Birkmose and Konstantinos Sergakis eds., Edward Elgar 2021).
33. *See, e.g.*, Jie Cai and Ralph Walkling, *Shareholders' Say on Pay: Does It Create Value*, 46 J. Financ. Quant. Anal. 2, 299–339 (2011); Fabrizio Ferri and David Maber, *Say on Pay Votes and CEO Compensation: Evidence from the UK*, 17 Review of Finance, 527–563 (2013); Gregorio Sanchez-Marin, Gabriel Lozano-Reina, Samuel Baixauli-Soler, and Maria Ernacion Lucas-Perez, *Say on Pay Effectiveness, Corporate Governance Mechanisms, and CEO Compensation Alignment*, 20 Business Research Quarterly, 226–239 (2017).
34. Institute for Policy Studies, *Executive Excess 2013: Bailed Out, Booted, and Busted*, 8 (IPS 2013) (25 March 2022), https://ips-dc.org/wp-content/uploads/2013/08/EE13-FINAL.pdf: 'Of the 500 slots on the highest-paid lists, 38 percent were held by CEOs who led firms that were bailed out or crashed in the 2008 financial crisis, wound up getting fired, or had to pay settlements or fines related to fraud charges'. Dittmann, Maug, and Zhang have shown that restrictions of executive pay packages are difficult to be structured and may have many negative consequences, depending on the restrictive technique being used (Ingolf Dittmann, Ernst Maug, and Dan Zhang, *Restricting CEO Pay*, 17 J. Corp. Finance 1200–1220 (2011).

compensation of the CEO to that of a median employee of that company.[35] Ratios of more than 900 to 1 are frequently found in the US.[36] The UK also requires listed companies with more than 250 employees to justify the pay packages of the CEO through the annual disclosure of the ratio of their CEO's pay to the median, lower quartile, and upper quartile pay of their UK employees,[37] but other jurisdictions did not follow in a similar way for disclosing pay ratios like they did for say on pay.

[E] Compensation as an Instrument for Sustainability

A recent remuneration trend which gained ground after the enactment of the International Treaty on Climate Change (Paris Agreement 2015)[38] is the inclusion of environmental, social, and governance (ESG) criteria in remuneration packages of executive directors.[39] According to CGLytics, only 3% of the companies included ESG criteria in a key performance indicator (KPI) in remuneration packages in 2008, increasing to 19% in 2013 and 27% in 2018.[40] The 'social' criterion was the first that was incorporated in the compensation package. Overall, the effect of these KPIs remains limited as in 2018 those ESG-measures accounted for less than 15% of the bonus. In 2020, already 45% of the UK Footsie 100 companies included at least one ESG-measure in their remuneration package, 37% in the annual bonus, and 19% in their long-term incentive scheme.[41] The energy industry is taking the lead. All companies in this industry include ESG measures, predominantly environmental criteria. In other industries, a social criterion is the most common. A similar increase of the use of ESG metrics

35. Section 953(b) Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, H.R. 4173 (July 2010) (the 'Dodd-Frank Act').
36. The Shearman and Sterling annual reviews of corporate governance practices found in nine (2021) and in six (2020) of the largest 100 companies exceeding this threshold (Shearman and Sterling, *Corporate Governance & Executive Compensation Survey 2021 and 2020* (25 March 2022), https://www.shearman.com/perspectives/2021/11/19th-annual-corporate-governance-executive-compensation--the-survey and https://www.shearman.com/perspectives/2020/09/corpgovsurvey2020/shearman-releases-18th-annual-corporate-governance-and-executive-compensation-survey.
37. Arts 19A to 19G of Schedule 8 of the remuneration report added by The Companies (Miscellaneous Reporting) Regulation 2018 (25 March 2022) https://www.legislation.gov.uk/uksi/2018/860/regulation/17/made.
38. For an overview of this agreement, *see* https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (25 March 2022).
39. Kristen Sullivan and Maureen Bujno, Incorporating ESG Measures into Executive Compensation Plans, Harvard Law School Forum on Corporate Governance (24 May 2021), https://corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/. Conversely, there are indications that corporate social responsibility (CSR) performance of companies also affect the structure of the compensation package. Companies with better CSR performance results pay their CEO a higher portion of equity-based compensation (Khondkar Karim, Eunju Lee, and Sanghuyn Suh, *Corporate Social Responsibility and CEO Compensation Structure*, 40 Advances in Accounting, 27–41 (2018)).
40. FTI Consulting and CGLytics, *ESG and Executive Remuneration – Disconnect or Growing Convergence*, 15 October 2019 (26 March 2022), https://corpgov.law.harvard.edu/2019/10/15/esg-and-executive-remuneration-disconnect-or-growing-convergence/.
41. Some companies included ESG measures in both compensation elements. PWC and London Business School, *Paying Well by Paying for Good*, 14 (2021).

in compensation plans is to be found in the US. Almost 70% of the S&P 500 companies include these metrics in the incentive plan in 2022.[42]

Some studies point at the positive effects of the inclusion of non-financial criteria in executive remuneration policies: firm innovation increased significantly with the inclusion of corporate social responsibility (CSR) criteria.[43] However, this rapid shift towards ESG-related compensation plans does not come without criticism. Bebchuk and Tallarita examine the ESG-incentives in the S&P 100 companies and show that the ESG-incentive mechanisms tie the pay to a (too) limited number of ESG-dimensions, which can even be harmful for stakeholder welfare. Next, the arrangements cannot easily be monitored by third parties. The scholars conclude that this new compensation development serves the interest of the executives and not the stakeholders.[44] Kay is more nuanced.[45] As her survey shows, there is an overwhelming support of different stakeholder classes for using ESG-compensation metrics, with careful monitoring, compensation can help reaching out towards a better-balanced stakeholder approach of US companies.

Recently, the European Commission promoted ESG criteria to the legislative level. In Article 15 of the proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, the Commission requires companies combatting climate change and setting variable remuneration considering the fulfilment of companies in that respect.[46]

[F] Compensation Levels

Notwithstanding the many regulatory interventions in setting remuneration, the total compensation of (executive) directors is almost always on the rise. Further, while many best practices in corporate governance codes have a similar approach of setting directors' remuneration, compensation packages seem to differ significantly between countries, with the total compensation being the highest in the US. Murphy pointed at the insignificance of the differences between pay packages of US CEOs and those in other countries, 'but rather reflects tighter links between CEO pay and shareholder

42. PayGovernance, *ESG Incentives: Intended to Improve Corporate and Societal, Environmental, and Social Outcomes* 10 May 2022 (25 May 2022), https://www.paygovernance.com/viewpoints/esg-incentives-intended-to-improve-corporate-and-societal-environmental-and-social-outcomes.
43. Albert Tsang, Kun Tracy Wang, Simeng Liu, and Li Yu, *Integration Corporate Social Responsibility Criteria into Executive Compensation and Firm Innovation: International Evidence*, 70 J. Corp. Finance 102070 (2021).
44. Bebchuk and Tallarita, *supra* n. 16.
45. Ira Kay, *The Perils and Questionable Promise of ESG-Based Compensation*: *A Response to Bebchuk and Tallarita* 27 April 2022 (25 May 2022) https://corpgov.law.harvard.edu/2022/04/27/the-perils-and-promise-of-esg-based-compensation-a-response-to-bebchuk-and-tallarita/.
46. Art. 15 of the proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 23 February 2022 (COM (2022) 71 Final). For the financial industry, this requirement already exists (*see* article 5 of Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.

performance in US firms'.[47] In seventeen out of twenty-two countries, the CEO pay package has grown between 1997 and 2005 with an average growth rate of 8%.[48] In the 2010s, more moderate pay increases resumed, resulting in median pay packages of more than USD 12 million for S&P 500 CEOs in 2020, almost three times as high as the package for a median Russell 3000 company of USD 4.5 million.[49] Edmans, Gabaix, and Jenter add to these findings the size of the median compensation package of non-CEO executives showing similar developments over time but at a significant lower level, with a median of USD 1.7 million in 1992 growing to USD 4.4 million in 2000, lowered to USD 3.5 million in 2008 and returning to USD 4.1 million in 2014.[50] For the smaller companies, the development of the total compensation of executive non-CEOs was much flatter with a median growing from USD 0.7 million in 1992 to USD 1.2 million in 2014.

Non-executive directors play, obviously, in a totally different league regarding compensation. According to a 2019 study by Korn Ferry, the median pay for a non-executive director of a European listed company was EUR 70,000 in 2018, varying from a low of only EUR 20,000 in Austria to a generous EUR 207,800 in Switzerland, the only country with a median exceeding EUR 100k.[51]

These levels of compensation do not differ dramatically from those of outside directors of American companies. The annual cash compensation of an American director accrued to USD 107.5k in 2018, and the average director receiving an additional retainer and meeting fee for taking part in a committee of the board. The major difference between the US and Europe lies in the recurring stock compensation. Almost all outside directors in the US receive this kind of compensation, with a median value of USD 150k.[52] Approximately 94% of the American companies have either stock ownership guidelines or retention requirements, and the median guideline value for non-executive directors reaches USD 500k. The difference between European and American companies regarding the retainer of shares and stock ownership in the company questions the best practice of shareholdings for non-executive and independent directors. In the next section, I study the best practices for non-executive and independent directors of holding and acquiring shares in the company.

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47. Murphy, *supra n.* 2.
48. Marc Goergen and Luc Renneboog, *Managerial Compensation*, 17 J. Corp. Finance 1068–1077 (2011).
49. Semler Brossy and the Conference Board, *CEO and Executive Compensation Practices in the Russell 3000 and S&P 500*, 5 (Conference Board Inc., October 2021). *See* for similar findings between 1992 and 2014, Alex Edmans, Xavier Gabaix, and David Jenter, *Executive Compensation: A Survey of Theory and Evidence*, in *The Handbook of the Economics of Corporate Governance*, 390 (Benjamin E. Hermalin, Michael S. Weisbach eds., Elsevier 2017).
50. Alex Edmans, Xavier Gabaix, and David Jenter, *Executive Compensation: A Survey of Theory and Evidence*, in *The Handbook of the Economics of Corporate Governance*, 391 (Benjamin E. Hermalin and Michael S. Weisbach eds., Elsevier 2017).
51. Korn Ferry, *Non-Executive Directors in Europe 2019*, 7 (Korn Ferry).
52. Willis Towers Watson, *Executive Compensation Bulletin*, 2 (Willis Towers Watson, 6 September 2018). The median director pay in 2020 topped $203k according to the NACD report (Pearl Meyer, *2020–2021 Director Compensation Report*, 15 NACD, Arlington, 2021). For comparability with the European data, the numbers of 2018 Willis Towers Watson study have been presented in the body of the chapter.

§9.02 THE NON-EXECUTIVE DIRECTOR AND REMUNERATION IN SHARES

An important component of many directors' pay packages is equity-based compensation. Granting (restricted) stock to executive managers and directors can motivate them to think and act like an 'owner' of the company. Further, it turns directors into shareholders and entitles them to all shareholder rights. (Non-executive) director ownership positively affects corporate performance,[53] and it improves monitoring over financial reporting.[54] The question whether a non-executive director needs to be a shareholder for holding the reins efficiently is commonly positively answered in the US. According to Warren Buffet, the chairman of the board of Berkshire Hathway Inc., there is little doubt that effective directors invest and hold shares in which they are a director. In his letter to the shareholders accompanying the annual report over 2019,[55] he wrote:

> Not long ago, I looked at the proxy material of a large American company and found that *eight* directors had never purchased a share of the company's stock *using their own money*. […] This particular company had long been a laggard, but the directors were doing wonderfully. Paid-with-my-own-money ownership, of course, does *not* create wisdom or ensure business smarts. Nevertheless, I feel better when directors of our portfolio companies have had the experience of purchasing shares with their savings, rather than simply having been the recipients of grants.

Buffet follows the American common practices. According to Skadden, Arps, Slate, Meagher, and Flom, American companies make use of stock ownership guidelines for directors.[56] The director must acquire and hold a meaningful number of shares. This stake should be accumulated within three to five years after the first appointment. The meaningful number is equal to a multiple of the annual cash compensation. The multiple varies commonly between three to five times this compensation.[57]

This view is not unanimously shared. According to others, stock-owning directors show more myopic behaviour booting the short-term stock price, and directors'

53. Sanjai Bahagat and Brian Bolton, *Director Ownership, Governance, and Performance*, 48 J. Financ. Quant. Anal. 1, 105–135 (2013).
54. Amanda Bree Josefy, *An Examination of Director Stock Ownership Requirements* (Texas A&M University, 2016) (24 May 2022), https://oaktrust.library.tamu.edu/bitstream/handle/1969.1/156916/JOSEFY-DISSERTATION-2016.pdf;sequence = 1.
55. Warren Buffett, *Letter to the Shareholders of Berkshire Hathaway Inc.* (22 February 2020).
56. Skadden, Arps, Slate, Meagher, and Flom LLP and Affiliates, *2021 Compensation Committee Handbook*, 101 (15 April 2022) https://www.skadden.com/insights/publications/2021/02/2021-compensation-committee-handbook.
57. According to the former report ISS recommends a multiple of four.

ownership can negatively affect their independence and objectivity.[58] Further, director ownership hinders the monitoring of excess CEO compensation.[59]

The number of studies assessing the effects of acquiring and holding shares as a non-executive director is limited, and its effects are not unambiguous. Whether this component of pay is to be considered as a good corporate governance practice or a legal requirement is not been studied intensively. The next sections address this underexposed topic.

[A] The Regulatory Framework

In many jurisdictions, concentrated ownership is a corporate characteristic. According to a recent Organisation for Economic Co-operation Development (OECD) corporate governance report, in thirty-three out of forty-five countries, more than 20% of the stock exchange listed companies have one shareholder owning more than 50% of the shares; in twelve countries, more than half of the companies have a majority shareholder; and in twenty-seven countries, the three largest shareholders own more than 50% of the shares.[60] Often, these shareholders are combining their ownership with a board position, either as an executive or as a non-executive. Warren Buffett serves as an example of this type of shareholder-director owning more than 38% of the high voting class A stock of Berkshire Hathaway Inc. according to the proxy statement 2021. However, many non-executive directors are elected by the general meeting of shareholders for their specific expertise and not for their shareholdings. Do these directors have to hold or acquire shares for effective governance or are shareholdings impairing their independence? This question is not answered in all jurisdictions in a similar way. I discuss whether the law provides in requirements for directors to hold or to acquire shares (§9.02[A][1]). Next, I study the best practices regarding the position of the non-executive director as shareholder in corporate governance codes (§9.02[A][2]). Section 9.02[B] analyses the practices of director's ownership in four countries with different best practices.

[1] The Director-Shareholder in the Law

In some jurisdictions, the former companies' acts considered that a director must be a shareholder. In France, the Companies Act of 1867 stated:

> Directors must own a number of shares determined by the articles of association. These shares serve the purpose of covering all management actions, even those

58. Jacob Rose, Cheri Mazza, Carolyn Norman, and Anna Rose, *The Influence of Director Stock Ownership and Board Discussion Transparency on Financial Reporting Quality*, 38 Account, Organizations and Society 5, 397–405 (2013).
59. Amanda Bree Josefy, An Examination of Director Stock Ownership Requirements (Texas A&M University, 2016) (24 May 2022), https://oaktrust.library.tamu.edu/bitstream/handle/1969.1/156916/JOSEFY-DISSERTATION-2016.pdf;sequence = 1.
60. OECD, *Corporate Governance Factbook 2021*, 26 (2021) (1 April 2022), https://www.oecd.org/corporate/corporategovernance-factbook.htm.

> that would be exclusively personal to one of the directors. They are nominative, inalienable, stamped with a stamp indicating inalienability, and deposited in the social fund.[61]

This ownership requirement was maintained in Article 95 of the Companies Act 1966 and even sanctioned. If a director did not own the required number of shares on the day of the appointment or ceases to own this number of shares during the term, then the director was deemed to have resigned from office if the director had not regularized it within three months. The scheme of this guarantee stock was abolished in 1988, and (only) in 2008 the system has reversed: only if the articles of the company require the director to acquire and to hold shares, the director must be a shareholder.[62] Many French companies still have this requirement in their articles of association but mostly with a very modest threshold.[63] A similar requirement was enacted in Article 47 of the Belgian companies act of 18 May 1873. First, different from the French requirement was that the director of a Belgian company must assign a number of shares as a guarantee of the management of the company. The director did not have to be a shareholder, if a shareholder was willing to provide in the guarantee in favour of the director. Second, the Belgian law provided in two thresholds. If the director had been identified by name in the articles of association, the director must deposit 2% of the shares as a guarantee. If the general meeting elected the director, then the latter must (have) deposit(ed) the number of shares as identified in the articles of association. The legislators in both France and Belgium were not worried that the interests of the directors were not aligned with the interests of the shareholders, but they wanted to address the issue of the directors' adequate management of the company. It is most obvious in the Belgian Companies Act of 1873 as the law did not retain the requirement of the director of (personally) being a shareholder.

Some other jurisdictions discussed the director's requirement of being a shareholder. When preparing the modernization of the Danish Companies Act, it was proposed in 1942 to introduce the requirement for directors to hold shares, but this proposal was rejected.[64] Also, here this proposal followed the idea of guaranteeing the good management of the company. The UK Companies Act 1948 did not require the director to hold shares but explicitly provided how the director must obtain shares in case the company provided in the articles of association this requirement:[65]

61. Art. 26 of the Law of 24 July 1867 on Companies: 'Les administrateurs doivent être propriétaires d'un nombre d'actions déterminé par les statuts. Ces actions sont affectées en totalité à la garantie de tous les actes de la gestion, même de ceux qui seraient exclusivement personnel à l'un des administrateurs. Elles sont nominatives, inaliénables, frappées d'un timbre indiquant l'inaliénabilité, et déposées dans la caisse sociale'.
62. Law n° 2008–776 of 4 August 2008 on the modernization of the economy, OJ 181, 5 August 2008.
63. It is not uncommon to stipulate in the articles of association that the director must own one share.
64. H. O. Jensen, *Træk af den danske Aktierets Udvikling i det syttende og attende Aarhundrede*, UfR Online 2–3 (U.1944B.221, 2016). My thanks go to Julie Nielsen for research assistance regarding these former Danish legal developments.
65. A common practice in former times (Susan McLaughlin, *Unlocking Company Law*, 230 (Routledge, Oxon, 2013)

> It shall be the duty of every director who is by the articles of the company required to hold a specified share qualification, and who is not already qualified, of directors, to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the articles. […] The office of director of a company shall be vacated if the director does not within two months from the date of his appointment, or within such shorter time as may be fixed by the articles, obtain his qualification, or if after the expiration of the said period or shorter time he ceases at any time to hold his qualification.[66]

With its rule on the holder of the share warrant, it has some resemblances with the former Belgian system. The UK Companies Act 2006 is no longer explicitly providing consequences for directors who fail to meet the requirements of the articles of association.[67]

In some other jurisdictions, there are specific shareholder requirements for directors. For example, in the US, to qualify as a director of a national bank[68] or its controlling entity, the director must be the owner of shareholders' equity with a value of USD 1,000.[69]

Requirements of memberships served the requisite of good management of the company rather than aligning the interests of the directors with the wealth maximization of the shareholders.

[2] Corporate Governance Best Practices

In current times, most of the jurisdictions do not provide legal requirements for directors to hold shares. Whether corporate governance codes consider the holding and/or acquisition of shares of non-executive directors as a best practice, I study next. The first corporate governance code, the UK Cadbury Code stresses the independent position of the non-executive directors and was vague in providing best practices related to shareholdings of directors: 'This means that apart from their directors' fees and *shareholdings*, they should be independent of management and free from any business or other relationship which could material interfere with the exercise of their independent judgement.'[70] The fees of the director should be reflecting the time commitment. Non-executive directors should not participate in a share option scheme and not be pensionable by the company.[71]

The code recognized the holding of shares but does not provide in best practices related to the acquisition of shares, the holding of a certain number of shares, or the payment of the director's fee in shares. The 1995 Greenbury Code advised in a further alignment of the interest of the shareholders and those of the directors, stating that (all)

66. Section 182 UK Companies Act 1948. A similar provision can be found in section 291 UK CA 1985.
67. Obviously, under the Companies Act 2006, the director that fails to hold the shares as required in the articles of association of the company, (s)he is in breach with section 171 CA 2006.
68. A national bank in the US is a commercial bank chartered by the US Treasury.
69. 12 CFR § 7.2005 – Ownership of stock necessary to qualify as director of a national bank.
70. The Committee on the Financial Aspects of Corporate Governance, *Report*, 4.12 (GEE December 1992).
71. *Ibid.*, 4.13.

directors are encouraged 'to acquire and retain significant shareholdings in their company so as to reinforce alignment of the interests of Directors and shareholders',[72] a clear position considering shares as an important governance instrument. In the 1998 Hampel Code, the committee considered that remuneration in shares can be a useful method for paying the non-executive directors, although it does not need to be a universal practice and the committee did not want to provide in guidelines identifying what proportion of the fee should be paid in shares.[73] None of the later editions of the UK Corporate Governance Code explicitly changed these approaches. In the current Code, the remuneration of the non-executive directors should reflect the time commitments and responsibilities of the role of the non-executive director.[74] There should not be share options or other performance-related elements included in the remuneration package, but the Code does not overrule the previous recommendations of share-based remuneration or holding shares. The Code only notes that when determining the independence of the director, the board must consider whether the director has or has had in the last three years a material business relationship with the company which includes the relationship as a shareholder.[75] The Code also refers to the articles of association for setting the remuneration of the non-executive directors, while the current Companies Act 2006 no longer provides in the mandatory rule of the consequences of a breach of the articles of association of the company of holdings of shares, like the Companies Act 1948 prescribed.[76]

The 2004 Belgian Corporate Governance Code approached the remuneration of the non-executive directors in a negative way. Those directors 'should not be entitled to performance-related remuneration such as bonuses, stock related long-term incentive schemes, fringe benefits or pension benefits.'[77] The approach allowed to take appropriately into account the – at that moment – mandatory rule that every director can always, without any cause or reason, be dismissed. Specific remuneration schemes could be a hindrance when applying this rule to the extent that companies could be confronted with extra costs when dismissing a director that go against the general principle of this '*ad nutum*' dismissal. The 2019 Companies Code abolished the principle of the '*ad nutum*' dismissal[78] but made explicit that an independent director cannot receive any kind of performance-related fee, and a contract with a non-executive, non-independent director containing any kind of variable remuneration is conditional on the approval of the general meeting of shareholders.[79] The 2020 Belgian Code on Corporate Governance expanded the remuneration policies that companies must take into consideration. First, it entered the rule that the remuneration should

72. Study Group chaired by Sir Richard Greenbury, *Directors' Remuneration*, 6.41 (GEE 17 July 1995).
73. Committee on Corporate Governance, *Final Report*, 4.8 (GEE January 1998).
74. Financial Reporting Council, *The UK Corporate Governance Code*, Provision 34 (Financial Reporting Council Limited, London, July 2018).
75. *Ibid.*, Provision 10.
76. *See* Buffett, *supra* n. 55.
77. Corporate Governance Committee, *Belgian Code on Corporate Governance*, Provision 7.4 (Brussels, 2004).
78. The Belgian Company Code changed the principle of 'ad nutum' dismissal into a default regime.
79. Article 7:92 Belgian Company Code.

reflect the responsibilities and the time commitment of the non-executive director, a provision that resembles the UK best practice. Further, the Code added that 'non-executive board member should receive part of their remuneration in the form of shares in the company. These shares should be held until at least one year after the non-executive board member leaves the board and at least three years after the moment of award.'[80] Share-based payments are to be considered fixed remuneration when granting the shares is provided upfront as a well-identified number of shares, even if the stock price fluctuates, and independent from any performance-related criterion.[81] Performance-related remuneration or stock options cannot be considered as a good corporate governance practice.[82] These provisions raise several questions such as how the company can state its compliance with the Code when a director ends its membership and has no longer any relationship with the company but should hold on to the shares.

It was shown that the French law required the directors to hold shares in the company until 2008. The system was largely eroded as the number of shares that a director must hold had to be determined in the articles of association, and many companies introduced in their articles a very low threshold. The first French corporate governance codes do not contain any other specific requirements for the remuneration of the non-executive directors. However, in the current French Corporate Code of Listed Corporations, the director must be a shareholder: 'the director should personally be a shareholder and, by virtue of the provisions in the by-laws or the internal rules, hold a minimum number of shares that is *significant* in relation to the compensation awarded to them. If he or she does not hold these shares when assuming office, he or she should use his or her compensation to acquire them'.[83] The remuneration should consider the attendance of the director, the responsibilities and time commitment, and the participation in specialized committees or specific functions like being chair of the board.[84] It is up to the board of directors to decide on the significance of this ownership in relation to the total remuneration of the director.

The corporate governance practices in the Netherlands were developed in another direction. In the first Dutch Corporate Governance Code of 1997, it was recommended that the members of the supervisory board do receive neither any performance related pay nor stock options, and if a member holds shares in the company, it 'should be for long-term investment'.[85] It was not further explained what this long-term investment entails. From 2003 onwards, every edition of the Dutch

80. Corporate Governance Committee, *Belgian Code on Corporate Governance*, Provision 7.6 (Brussels, 2019).
81. Thomas Douillet, *La gouvernance des rémunerations des dirigeants dans les sociétés cotées – le point après le code des sociétés et des associations, le code de gouvernance 2020 et la loi droit des actionnaires II*, Revue de Droit Social 580–639, 607 (2020); Jan van Gysegem and Wim Devos, *De Corporate Governance Wet : eerste indicaties van de gevolgen in de praktijk van de bepalingen inzake variabele verloning en vertrek-vergoedingen*, 8 Oriëntatie 4, 224 (2011).
82. *Supra* n. 77, Provision 7.4 and 7.6.
83. Afep-Medef, *Corporate Governance Code of Listed Corporations*, Provision 20 (Paris, 2020).
84. *Ibid.*, 21.
85. Committee on Corporate Governance, *Recommendations on Corporate Governance in the Netherlands – Forty Recommendations*, Provision 2.12 (25 June 1997).

Corporate Governance Code – 2003, 2008, 2016, and the draft 2022 edition – explicitly states that 'the remuneration of the supervisory board members should reflect the time spent and the responsibilities of their role … may not be awarded remuneration in the form of shares and/or rights to shares …and… shares held by a supervisory board member in the company on whose supervisory board they serve should be long-term investments.'[86] The board member should be remunerated in a way that it 'promotes an adequate performance of their role',[87] but shares should not be a part of the compensation.

In short, these jurisdictions show that the best practices of the compensation and position of the non-executive director as shareholder differ substantially. A French non-executive director should acquire and hold a significant number of shares which is since 2020 also seen as a best practice in Belgium. In both countries, the acquisition of shares should follow from the remuneration of the director. The older UK Codes had a similar approach, but more recently this remuneration practice is less pronounced. Receiving compensation in shares is considered a bad practice in the Netherlands. A Dutch (supervisory) board member can own shares as a long-term investment, but a director without shares is considered all but problematic.

[B] The Non-executive Director and Remuneration in Shares: Governance Practices

[1] Framework of the Study

Assessing the practices and effects of the corporate governance codes on shareholdings of non-executive directors, I study the evolution of the shareholdings and compensation of non-executive directors in listed real estate investment trusts in the aforementioned four countries, Belgium, France, the UK, and the Netherlands. The countries were selected based on the differences and developments of their best remuneration practices. Belgium started to recommend non-executive directors to hold and to invest (part of their remuneration) in shares in the Corporate Governance Code 2020. The Dutch corporate governance code recommends the company not to award non-executive directors (and supervisory board members) in (options of) shares, and in case this type of director is a shareholder, then the ownership must be considered as a long-term investment. The UK practices hold the middle between Belgium and the Netherlands. The non-executive directors should not be paid in share options or performance-related elements, but the holding of shares is considered appropriate if the position as shareholder does not result in a material business relationship. Finally, French best practice includes that the non-executive director is a shareholder of the company and acquires shares with the compensation (s)he receives as a board

86. Provision 3.3.1, 3.3.2, and 3.3.3 of the draft 2022 Dutch Corporate Governance Code (unchanged from the 2016 Code).
87. Monitoring Committee Corporate Governance Code, *The Dutch Corporate Governance Code*, Principle 3.3 (8 December 2016).

member. How these different recommendations affect the holding and acquisition of shares of the non-executive directors is studied in this section.

For comparability reasons, I made use of companies in one industry, the real estate. The Euronext IEIF REIT Europe index, which, at the start of 2022, contained forty-seven listed real estate companies in seven European countries, was used to select the companies in the four countries in this assessment. I selected seven Belgian companies for investigating the developments of acquisitions of shares before and after the introduction of the 2020 Corporate Governance Code. The Netherlands has only three representative companies in the REIT index, but I added one other Dutch REIT company, Wereldhave.[88] For the UK and France, I randomly selected five companies of each country. For France, I added a sixth French company Unibail-Rodamco-WE, which has French, Dutch, and Australian roots. This company has a two-tier board structure, like one of the other French companies, in that way balancing the different board structures of the selected French companies.

For each of the companies, I identified all the non-executive directors or, for the Dutch and some French companies, the members of the supervisory board in the period from 2017 to 2021, and for each of these directors their ownership of shares. Table 9.1 provides an overview of the number of companies, the number of directors, the number of director-years, and the number of observations. A substantial number of non-executive directors left the board between 2017 and 2021 and similarly a considerable number was newly elected. Non-executive director turnover was the highest in the UK where only 25% of the directors have been board member over the five consecutive years. In Belgium, the turnover was the lowest: 62% of the non-executive board members stayed as member of the board between 2017 and 2021. Dutch and French non-executives were in the middle of Belgium and the UK with 42% and 49% of the non-executives being member of the board in all five years. Consequently, the number of director-years of observations is lower than the number of directors multiplied with the number of years. Finally, the annual report of Belgian companies does not always disclose whether the non-executive directors are also shareholder and how many shares the non-executive director holds.[89] Since 2020, this lack of information was remedied. It explains the lower number of total observations for the Belgian companies. The regular changes of non-executive directors in the board questions whether any kind of recommendation – either to acquire shares and hold shares or the opposite – could significantly affect their (independent) opinion.

88. This company is added providing a better balance in the number of companies of the different jurisdictions. The size of Wereldhave is close to that one that is requested for becoming part of the REIT index.
89. I also have controlled the database of the transactions in financial instruments of the issuer (in accordance with Article 19 of the Market Abuse Regulation (EU) No. 596/2014), which the Belgian regulator FSMA, pursuant to Art. 25, §2, of the Law of 2 August 2002 on the supervision of the financial sector and on financial services, discloses on its website. This database did not provide any transaction information of the directors of the companies for which the annual report does not contain the shareholdings in the period 2017–2019.

Table 9.1 Overview of the Sample of Companies and Director Observations

	Companies	Directors	Dir.* Years	Observ.
Belgium	7	61	248	187
France	6	65	246	246
Netherlands	4	24	87	87
UK	5	54	167	167
All	22	206	748	687

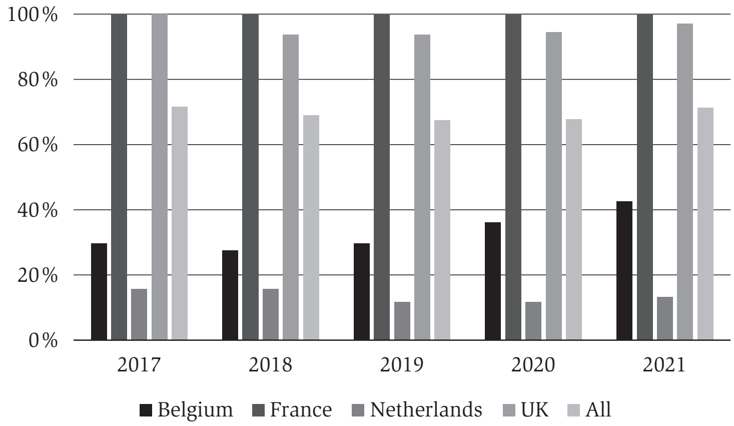
Source: own research based on the annual report of the REITs.

[2] Frequency of Non-executive Director Shareholdings

Figure 9.1 provides an overview of the non-executive directors' holdings of shares in the real estate investment trust industry. All French directors and as good as all UK directors hold shares in the company. The few non-executive directors of UK companies that do not hold shares were recently elected. In the consecutive year, the annual reports show that those directors were building up a share stake. Developments take place in Belgian companies. From 2017 to 2019, less than 30% of the non-executive directors hold shares in their company. This relative number increased between 36% in 2020 and 43% in 2021. The 2020 Belgian Code on Corporate Governance was published in early 2019 and came into effect in 2020. Consequently, directors and their companies had a reasonable period to comply with the new best practice, but compliance remained modest. Some companies consider it an unnecessary provision. At the other end of the spectrum are the directors of Dutch companies. Only 10% to 15% of the supervisory board members of the Dutch REITs in this sample hold shares in the company.

Overall, there is a significant effect of the best practices on the behaviour of non-executive directors as to the holding of shares. In France and the UK, holding shares is since many years considered an extension of a directorship. In Belgium, this new best practice will take time to get embedded in corporate governance. The Dutch findings support the opposite best practice.

Figure 9.1 Number of Non-Executive Directors Holding Shares in the Company



Source: Own research based on the annual report of the REITs.

[3] Evolution of Shareholdings of Non-executive Directors

In some of the jurisdictions, directors do not immediately have to comply with the best practice of holding shares and are granted an acquisition period. Especially in France and Belgium, part of the remuneration can be provided in shares. In the latter country, this component of remuneration should continue for the time the non-executive director remains a member of the board. It results in four different approaches. Since 2020, Belgian directors should yearly increase their shareholdings in the company. The French directors should already from the start own a significant number of shares or start acquiring the shares from the first year of the election. In the UK, it depends on the remuneration practices of the company whether the non-executive director should be a shareholder and increase its shareholdings regularly, while in the Netherlands, shareholdings should be the exception to the rule.

The results of the study largely confirm these hypotheses, Belgium being the exception. First, in French companies, the candidate for a board membership hold shares when the general meeting elects the director. Only a minority of directors further increases its shareholdings. Their shareholdings remain largely unchanged after the election to the board and rarely the director decreases its stake. The next section addresses the question whether the shareholdings can be considered significant. In the UK, it is a common practice that a candidate for the board of directors has acquired shares and further develops its shareholdings during the term of the directorship. As the current UK Code is silent, but refers to the articles of association, it is common (in our sample) that the articles provide in a minimum threshold of shareholding for non-executive directors. For example, Land Securities states:

> Non-executive Directors are expected to meet a minimum shareholding requirement of 100% of the relevant annual fee within three years of appointment to the Board. The shareholding requirements are considered met once the Non-executive Director has obtained the required holding value and, provided those shares are retained, no adjustment is required due to movements in the share price.[90]

The evolution of the Dutch ownership of shares of supervisory board members supports the best practices of the Dutch Code. Most of the directors do not own shares (Figure 9.1), and only rarely does the supervisory director acquire shares during the term as board member (Table 9.2). For Belgium, it is expected that since 2020, non-executive directors start to yearly acquire shares in the company, but the results do not confirm this hypothesis. A large majority of the non-executives do not change their shareholdings, and less than half of the directors hold shares in the company in 2021 (Figure 9.1), resulting in a common practice opposite to the best practice in the Belgian Code on Corporate Governance.[91] Only a few directors increased their holdings, especially in one company that amended its corporate governance practices in 2016 supporting the directors' acquisition of shares in line with, but long before, the amendment of the Belgian Code in 2020.

Table 9.2 Developments of the Shareholdings of Non-executive Directors (Increase/Decrease/Unchanged Holdings)

	2017–2018	2018–2019	2019–2020	2020–2021
Belgium	17%/0%/83%	11%/0%/89%	22%/5%/73%	13%/2%/85%
France	19%/5%/76%	14%/2%/84%	31%/4%/65%	22%/9%/69%
The Netherlands	0%/0%/100%	0%/0%/100%	0%/0%/100%	7%/0%/93%
UK	42%/16%/42%	33%/0%/67%	41%/0%/59%	34%/0%/66%
All	21%/5%/74%	16%/1%/83%	27%/3%/70%	20%/4%/76%

Source: Own research based on the annual report of the REITs.

[4] Size of the Shareholdings of Non-executive Directors

The French Corporate Governance Code recommends the non-executive directors to hold a *significant* number of shares in the company. The current UK Code does not provide in a similar requirement, but it was recommended in the former Code. The

90. Land Securities, *Annual Report 2021*, 125.
91. This finding confirms a VBO-Guberna study of the compliance of companies with the Belgian Corporate Governance Code 2020. According to the study, only 11% of the companies partially compensates their non-executive directors in shares. In the group of the largest companies, already 41% remunerates in shares, but none of the smaller companies provides shares to their non-executive directors as part of their pay (Guberna-VBO, *Studierapport – Naleving van de Belgische Corporate Governance Code 2020*, 12 (2021)). Many companies explain why they do not complain with this best practice.

Belgian Code does not specify the size of the shareholdings but contain the recommendation of a yearly acquisition of shares while the Dutch Code does not recommend acquisitions or holdings of shares.

As there are major differences in the total number of shares that companies issued, I calculated the value of the shareholdings of each director at the end of each year (and converted the UK values into Euro). In case a director does not hold any shares, the value of the stake is 0.

In France it regularly occurs that a legal entity, holding a substantial number of shares is elected as a board member.[92] As these observations significantly influence the average value, these non-executive directors have been excluded in Table 9.3.[93] Also one non-executive director of a significant shareholder in a UK company was excluded.[94]

Table 9.3 provides the results of this analysis. The average shareholdings of a non-executive director in the real estate investments trust varies between EUR 75,000 and EUR 110,000 in the period from 2017 to 2021. These averages hide significant differences as the median values ranged from EUR 8,000 to EUR 18,000 due to the large number of non-executive directors that do not hold any shares and a few non-executive directors that hold share packages exceeding a value of EUR 1 million.

The French Code recommends the holding of a *significant* number of shares in relation to the compensation. Overall, the average value of the shareholdings is rather modest and varies between EUR 21,000 and EUR 35,000.[95] The median value of the shareholdings remains for every year even under EUR 16,200. As the average yearly total remuneration of the non-executive director of French companies in 2019 and 2020 approached EUR 50,000, it can be doubted that the average shareholding complies with the French best practice. This is different for the UK companies. The average value of the shareholdings of non-executive directors of UK REIT companies fluctuates significantly between EUR 158,000 in 2019 and EUR 671,000 in 2021, with medians varying from EUR 71,000 to EUR 135,000, both set of numbers show the significance of the shareholdings. With an average overall remuneration of EUR 127,000 in 2019 and 2020, many non-executive directors hold an investment in the company that exceeds their annual remuneration. In Belgium, the average value of the shareholdings increased significantly in 2019 and remained at this high level in the follow up years. This is due to a few independent directors that hold and increased their stakes in the company. Overall, the majority of the directors do not hold shares in the company, and the median value of the shareholdings of a non-executive director in Belgian REITs is nil. A similar finding is noted for the supervisory board members of Dutch companies. Only a few members of the Dutch supervisory board hold shares in the company, and since 2019 only one director's shareholdings exceeded a value of EUR 100,000. In

92. The legal entity is represented by a natural person.
93. In many cases, the value of the shareholding exceeded EUR 100 mio.
94. The disclosure of the director holdings referred to the shareholdings of the significant shareholder.
95. In 2018, we excluded the shareholdings of one director of Unibail-Rodamco-WE as this non-executive director had an Australian background. Including his holdings in the 2018 would increase the average almost 4 times to more than EUR 76.000.

recent years, and contrary to the (value of the) shareholdings of non-executive directors in Belgian, the value of the board members of Dutch companies decreased to amounts between EUR 10,000 and EUR 15,000.

Table 9.3 Average Value of the Shareholdings of a Non-Executive Director (in EUR)[96]

	2017	2018	2019	2020	2021
Belgium	10,602	10,658	113,576	113,360	163,176
France	32,933	21,305	35,066	23,231	21,918
Netherlands	39,533	27,343	13,198	11,197	14,160
UK	335,741	254,457	158,111	428,033	670,639
All	108,444	99,459	84,271	75,430	106,110
N	122	124	129	144	139

Source: own research based on the annual report of the REITs

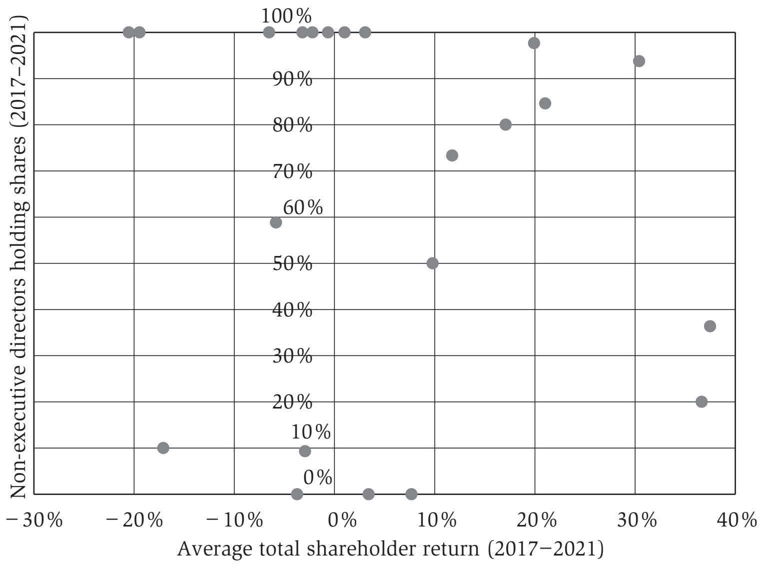
[5] Company Performance and Shareholding of the Non-Executive Directors

The shareholdings of non-executive directors, and especially independent directors should not impair their judgment but as a former UK code stated it can be encouraged 'to reinforce alignment of the interests'.[97] Thereto, I also have related the shareholdings of the non-executive directors to the total shareholder return. I assessed for each of the companies in the sample the total shareholder return as the stock price evolution over the year and the distributed dividend to the stock price at the start of the year, and averaged over the different years. As a proxy for the shareholdings of the non-executive directors, I used the average relative number of non-executive directors that hold shares in the company. The result of this analysis is presented in Figure 9.2. When more non-executive directors hold larger shareholdings in the company, it could be expected that the board is putting more emphasis on the financial return of the shareholders. It should result in observations that go from the lower left in the figure to the higher right side. The results do not confirm this hypothesis. The highest total shareholder returns of more than 20% are found in some companies with low levels of non-executive directors' holdings of shares as well as at high levels. Low and negative total shareholder returns can be found in companies where all non-executive directors hold shares as well as in companies were none or one of the non-executive directors hold shares. While the number of observations is too limited to generalize the findings, there is an indication that neither a best practice to recommend the acquisition and holding of shares nor a recommendation to refrain non-executive directors from

96. The value of the shareholdings of directors in UK companies have been converted in Euro.
97. Study Group chaired by Sir Richard Greenbury, *Directors' Remuneration*, 6.41 (GEE 17 July 1995).

acquiring shares should be considered as good corporate governance, *from a shareholder return perspective*.

Figure 9.2 The Relationship of the Total Shareholder Return to the Number of Non-executive Directors Holding Shares



Source: Own research based on the annual report of the REITs, share prices of Euronext and LSE.

§9.03 CONCLUSION

The remuneration and the optimization of the remuneration package of the board and executive management plays a key role in company management, even long before the term corporate governance entered the corporate arena. Since the start of the corporate governance discussions, compensation belongs to the key instruments for shaping a good corporate environment. For a long time, compensation was approached as a solution for agency conflicts and in particular aligning the interests of executive board members and management with shareholder wealth, in more recent times it started to be seen as a problematic area of governance. In all corporate governance codes that have been issued since the 1990s, the remuneration of the board and top executives takes a major part of the recommendations, especially, the alignment of the remuneration of the management and the directors with the interests of the company, the shareholders, and the stakeholders. Share and share options are as good as always instruments used to reach out to good corporate governance for executive board members.

The remuneration of non-executive directors is less of an issue. At first sight, it looks as if good corporate governance includes a fixed fee for the non-executive director, share options or performance-related compensation are bad governance practice, and holding shares is tolerated. In a more detailed study, I found that the best practices differ for non-executive directors from jurisdiction to jurisdiction. Some jurisdictions recommend a fixed fee which include (partial) payment in shares, while others recommend a significant holding of shares for non-executive director, and some codes do not want companies to pay non-executive board members in shares and refrain from recommending any holding of shares.

These best practices affect the behaviour of companies. The Dutch Corporate Governance Code considers it a bad practice to award non-executive directors (and supervisory board members) in (options of) shares, and only a limited number of supervisory board members hold shares. The opposite practice can be found in France where all non-executive directors hold shares. The French code considers a significant shareholding of a non-executive director as a best practice. However, while all directors own shares, most non-executive directors hold only a modest number of shares which more than likely fails to meet the standard of the French code of a 'significant' stake. Non-executive directors in the UK, another country where approximately all directors hold shares, build up *significant* shareholdings. Recent UK codes do not explicitly recommend it but leave it to the company to develop an appropriate practice. Finally, the Belgian best practice significantly changed in 2020. Currently, non-executive directors should be partially compensated in shares. However, corporate practice is unruly. Less than half of the non-executive directors hold shares, and only a few are compensated partially in shares. Finally, there is some preliminary evidence that shareholdings of non-executive directors have no direct effect on the total shareholder return of the company.

It is surprising that the *best governance practice* of acquiring and holding shares in the company as a non-executive director is differently approached in different jurisdictions. Corporate governance environments in many countries are, regarding this corporate governance feature, similar and it is hard to explain why best practices are divergent. Consequently, it is less surprising to find that companies approach these 'best practices' in different ways. In the absence of convincing arguments related to recommending or dissuading non-executive directors in acquiring or holding shares, I make a plea for a 'best practice' of developing a company specific policy for non-executive directors' remuneration which the shareholders will regularly assess when voting for this remuneration policy. In this policy, the company establishes how it will remunerate their non-executive directors and whether the directors must acquire and hold shares.