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Do the European and Dutch rules on Variable Remuneration of Financial Institutions Match and Can Remuneration be Regulated on a European Level?

D.E.M. Kromwijk and W.J. Oostwouder[1]

The special committee of inquiry into the financial crisis (Tijdelijke commissie onderzoek financieel stelsel), *better known as the De Wit Committee was in charge of investigating for the second chamber of the Dutch Parliament how the credit crisis had originated and how a future crisis could be prevented. In its report, the Committee paid special attention to the influence of remuneration on the crisis. In its final report, three of the twenty five recommendations concerned remuneration. Not only in the Netherlands was there attention for the incentives of remuneration and their role in the credit crisis, but also in the rest of the world. There are three different theories which try to explain the existence of variable remuneration: the agency theory, the market theory and the corporate governance theory. This article describes the European and Dutch rules on variable remuneration of executive board members and where possible also of employee remuneration. However, these rules are not always clear-cut. In this article, discrepancies between the European and the Dutch rules will be discussed. In this article, variable remuneration will thus be considered as a tool to solve the agency problem. The total remuneration (including the variable remuneration) can be seen as an instrument to attract and bind board members.*

Keywords: variable remuneration, financial institution, Europe, Dutch

I. Variable Remuneration and the Credit Crunch

On the 10th of May 2010, the special committee of inquiry into the financial crisis *(Tijdelijke commissie onderzoek financieel stelsel)*, better known as the De Wit Committee[2] reported its findings.[3] The De Wit Committee was in charge of investigating for the second chamber of the Dutch Parliament how the

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[2] For more information on the De Wit Committee: NRC Handelsblad, Like US, Dutch launch inquiry into banking crisis, 18 January 2010.

[3] Parliamentary paper 31 980, nrs. 3-4.

credit crisis had originated and how a future crisis could be prevented. In its report, the Committee paid special attention to the influence of remuneration on the crisis. In its final report, three of the twenty five recommendations concerned remuneration. Not only in the Netherlands was there attention for the incentives of remuneration and their role in the credit crisis, but also in the rest of the world.[4] Especially the unbalanced variable compensation element is said to have led to undesirable behaviours ranging from excessive risk-taking to an over emphasis on short-term results.[5] Between 52% and 80% of the market participants have acknowledged that the remuneration policies have contributed in a substantial manner to the credit crisis.[6] The remuneration subject therefore has extensively been and still is discussed.[7] In these discussions, however, the height of remuneration seems to receive more attention than the structure of remuneration whereas it is the structure rather than the height that gives (negative) incentives which have led and still lead to excessive risk-taking and an over emphasis on short-term results.[8] In the diverse proposals[9] which try to reform and/or regulate the remuneration subject, the concept of the influence of remuneration structures rather than remuneration height has been grasped. This article will therefore mostly focus on the remuneration structure of the financial sector rather than on the level of remuneration.

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[4] See for example Institute of International Finance, Compensation in financial services, Industry Progress and the Agenda for Change, March 2009, p. 1, Financial Stability Forum, FSF Principles for sound compensation practices, 2 April 2009, p. 1, G. Ferrarini, N. Moloney, M.C. Ungureanu, Understanding Director's Pay in Europe: A Comparative and Empirical Analysis, ecgi, law working paper n° 126/2009, June 2009, p. 3 or CRMPG III, Containing systemic risk: the road to reform, 6 August 2008, p. 5. Also see FD.nl, De Vries: 'Beloning topbestuurders oorzaak kredietcrisis', 27 January 2010 or COM(2009) 362.

[5] PricewaterhouseCoopers, Reward: a new paradigm? September 2008, p. 9.

[6] According to KPMG, 52% of the market participants agree upon the fact that incentives and remuneration have contributed to the credit crisis (KPMG, Never again? Risk management in banking beyond the credit crisis, January 2009, p. 7). According to PricewaterhouseCoopers, 70% of the market participants have acknowledged that the reward system has created the conditions for the credit/banking crisis (PricewaterhouseCoopers, Reward: a new paradigm? September 2008, p. 11). Finally, the Financial Stability Forum notes that over 80% of the market participants believe that compensation practices have played a role in the accumulation of risk-taking which led to the crisis (Financial Stability Forum, FSF Principles for sound compensation practices, 2 April 2009, p. 4).

[7] A recent example is an analysis of eerlijkebanwijzer of the remuneration of Dutch banks. See: http://www.eerlijkebankwijzer.nl/

[8] For a nuancing of the contribution of variable remuneration to the credit crisis, see the article of B.J. Schoordijk, De bonus in malus – variabele beloning en corporate governance, which will appear in the anniversary publication of the Nederlandse Genootschap Bedrijfsjuristen, October 2010.

This article describes the European and Dutch rules on variable remuneration of executive board members[10] and where possible also of employee remuneration. However, these rules are not always clear-cut. In this article, discrepancies between the European and the Dutch rules will be discussed. Two questions will be raised: can remuneration be regulated on a European level? And should concrete rules be favoured over vague rules?

II. Variable Remuneration – Three Theories

There are three different theories which try to explain the existence of variable remuneration: the agency theory, the market theory and the corporate governance theory. According to the agency theory, remuneration structures and especially the variable remuneration of board members find their origin in agency costs such as self-enrichment, conflict of interests, empire building or risk-avoiding behaviour[11] which are caused by the separation of control and ownership.[12] The agency problem describes the inherent tension between the shareholders who own the enterprise, and the board members who have the daily control over the enterprise and are the agent of the shareholders. Remuneration and particularly variable remuneration is used to minimise these costs, by giving

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[9] Examples on an international level: Basel Committee on Banking Supervision's Compensation Principles and Standards Assessment Methodology (January 2010), the report of the High-Level Group on financial supervision in the EU (25 February 2009, High-Level Principles for remuneration of the CEBS (20 April 2009), a couple of EU recommendations: 2004/913/EC, 2005/162/EC, C(2009) 3177 and C(2009) 3159, the Enhancing corporate governance for Banking Organizations reports of 1999 and 2006 of the Basel Committee on Banking Supervision, Principles for sound compensation practices of the Financial Stability Forum (April 2009), the Financial Stability Board implementation standards of the principles for sound compensation practices (25 September 2009), the corporate governance principles of the Organization for Economic co-operation and development (1999 and 2004) and the Principles of conduct and best practice recommendations of the Institute of International Finance (July 2008).

[10] In this article whenever referring to the board or board members, reference is made to the board of directors or the directors since the Dutch system of corporate organisation is a dualistic system, meaning that the board of directors and the supervisory board are two different boards.

[11] See J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p. 292. Also see S.C. Peij et al., Handboek corporate governance, Deventer: Kluwer 2008, p. 71-72 and B.T.M. Steins Bisschop, Beloningssystemen: de ongerechtvaardigde hypothese van parallelle belangen tussen aandeelhouders en bestuurders, Tijdschrift voor Ondernemingsbestuur 2006,, p. 52-53.

[12] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p. 291.

board members incentives to act in the interest of the shareholders. The agency theory uses remuneration as an instrument to resolve the agency problematic.[13]

The market theory defines remuneration in terms of the market mechanism: the remuneration of board members is based on supply and demand in the labour market.[14] If there is a large pool of qualified resources available and interested in filling up board member vacancies, the remuneration that will be paid to hire board members should be lower than if only a small number of resources is interested. The market mechanism theory therefore does not so much use remuneration as an instrument, but sees remuneration as a result of negotiation.[15]

Since this second theory does not explain the big differences observed in remuneration between board members in similar situations in it self, a third theory was developed. This theory considers (the level of) remuneration as a result of corporate governance.[16] The remuneration shows the relative power of board members in comparison to the other parties who are involved in determining the remuneration. The market first determines a rather large range of possible remuneration alternatives. Then, within this given range, the board member will try to influence his/her own remuneration. The more relative power the board member has, the higher the remuneration will be or the better the remuneration structure will be for the board member.

In the literature, the agency theory seems to have the upper hand and will therefore be used.[17] In this article, variable remuneration will thus be considered as a tool to solve the agency problem. The total remuneration (including the variable remuneration) can be seen as an instrument to attract and bind board members.[18]

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[13] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p.292. Whether a combination of fixed and variable (performance related) remuneration can actually put an end to the agency problematic is questionable: see B.T.M. Steins Bisschop, Beloningssystemen: de ongerechtvaardigde hypothese van parallelle belangen tussen aandeelhouders en bestuurders, Tijdschrift voor Ondernemingsbestuur 2006, on this issue.

[14] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p. 292-293.

[15] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p.292.

[16] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p.293-294.

[17] J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p. 291.

III. European Rules

On a European level, the remuneration subject is taken very seriously.[19] De Larosière paid attention to the subject in his 2009 report of the high level group on financial supervision in the EU[20], the Committee of European Banking Supervisors (the "CEBS") adopted the High Level Principles for Remuneration Policies[21] and the European Commission updated its 2004[22] and 2005[23] recommendations on remuneration and even came with a specific recommendation[24] on the remuneration in the financial services sector.[25] Although the European Commission expects that the member states implement the recommendations, they are not legally binding.[26] On the 2nd of July 2010, the Commission reported on the application by the member states of both recommendations.[27] The results of these evaluations are disappointing. When it comes to the Recommendation on remuneration policies in the financial services sector, eleven member states have not yet adopted any measures in accordance with it. Out of the 16 member states who have adopted measures, only seven have taken measures that cover the remuneration of all financial institutions. As to the application of the Recommendation on director's remuneration, it is even more disappointing as only 10 member states have implemented at least half of the recommendations.

On the 18th of May 2010, the European Parliament adopted a resolution on deontological questions related to companies' management.[28] In this resolution, the Parliament agrees that the credit crisis has shown that there are close links between risk management and remuneration policies and that the mis-

[18] N. Veldhoven and M.F. Landkroon, Principes voor beheerst beloningsbeleid: mooi in theorie én in de praktijk? V&O 2009, p. 127.

[19] See for exemple SEC(2009) 580.

[20] High Level Group on financial supervision, Report, 25 February 2009

[21] Committee of European Banking Supervisors, High-level Principles for Remuneration Policies, 20 April 2009. Also see for an evaluation of the implementation of these Principles: CEBS report on national implementation of CEBS High-level Principles for Remuneration Policies of 11 June 2010.

[22] 2004/913/EC.

[23] 2005/162/EC.

[24] C(2009) 3177 and C(2009) 3159.

[25] For an extensive discussion of the De Larosière report, the High Level Principle of the CEBS and the two recommendations, see the Dutch Parliamentary paper 31980, nr. 6, annex 3.

[26] Article 288 Treaty of the European Union (ex article 249 Treaty establishing the European Community) states that Recommendations are not binding.

[27] COM(2010) 285 final and COM(2010) 286 final.

[28] 2009/2711 (INI).

aligned incentives of the remuneration policies have – amongst others – played a central role in the crisis. Although the Parliament welcomes the two recommendations of the European Commission, it is convinced that this soft law approach of the remuneration subject is not satisfactory. The results of the evaluations dated the 2nd of July[29] seem to be an indication that the Parliament is right about this.[30] In its resolution on deontological questions related to companies' management, the Parliament therefore welcomes the amendment of the Capital Requirements Directive (the "**CRD**"), as the remuneration subject is explicitly introduced in it.[31] In this amended directive, CRD III[32] is regulated that credit institutions and investment funds have the obligation to "establish and maintain, for those categories of staff whose professional activities have a material impact on their risk profile, remuneration policies and practices that are consistent with effective risk management."

The more specific provisions on remuneration will be placed in schedule V of the CRD. On 14 June 2010, the Committee on Economic and Monetary Affairs, recommended to amend CRD III by adding some concrete measures, such as that at least 50% of the deferred part of the variable remuneration should be paid in shares or similar instruments.[33] On the 7th of July 2010, the European Parliament voted in favor of these amendments, which means that the European Union should have binding and mandatory rules on remuneration from January 2011 onwards. The directive contains certain vague provisions such as that besides financial criteria, non-financial criteria should also be taken into account when setting the remuneration and that institutions should set appropriate ratios between the fixed and the variable element of the remuneration. It also contains clear-cut rules, such as that at least 40% of the variable remuneration should be deferred. This amount of 40% can change to 60% if the variable remuneration is exceptionally high. This is actually also where the rule becomes less clear, as the directive does not express what it considers to be an exceptionally high variable remuneration. According to some,[34] if the 50% rule and the 40/60% rule are combined, then it becomes clear that it is never pos-

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[29] COM(2010) 285 final and COM(2010) 286 final.

[30] Also see 2010/2009(INI) under H, Rapporteur: Saïd El Khadraoui.

[31] At this moment, there are three different CRD's and there are plans to introduce CRD IV and V as well. The last amended version is CRD III. CRD I: 2006/48 EC and 2006/49 EC, CRD II: 2009/111/EC, 2009/27/EC, 2009/83/EC, CRD III: COM(2009) 362. Also see R. Wibier and R Labeur, Kroniek van het financiële recht, Nederlands Juristenblad, 16 04 2010, issue 15, p. 1011.

[32] COM(2009) 362.

[33] http://www.europarl.europa.eu/oeil/file.jsp?id=5788072

sible to grant more than 30% of the variable remuneration in upfront cash. An additional 20% could be paid in cash but this would be a deferred payment. To this conclusion they came by interpreting the 50% as meaning that 50% should be taken of both the deferred and the non-deferred part of the remuneration. An example: if an employee is entitled to a variable remuneration of € 100'000, then at least € 40'000 should be deferred and € 60'000 can maximally be non-deferred. The 50% rule would apply to both the deferred and the non-deferred category, meaning that € 30'000 of the € 60'000 should be paid in shares or similar instruments. This would leave € 30'000 to pay the employee directly in cash, meaning 30% of his/her variable remuneration. The possibility of adding an additional 20% of cash remuneration is obtained by taking 50% of the deferred € 40'000, equalling €20'000. As will be set out below in the paragraph on shortcomings, it is not certain that these two rules can be interpreted in such way.

Also on the 7th of July 2010, the European Parliament adopted a resolution on the remuneration of directors of listed companies and remuneration policies in the financial services sector.[35] It is important to note that this resolution does not only cover the remuneration of the financial services sector, but also of directors of all listed companies. In this resolution, the Parliament expresses many opinions varying from considering that non-executive board members (or the supervisory board) should not be compensated in variable remuneration to stating that directors should not be driven by their personal financial interest when managing a listed enterprise. Besides expressing some opinions, the Parliament also has a few requests for the European Commission. Some examples: the Parliament asks the Commission to establish binding rules, comparable to the ones in CRD III, for all listed companies on the remuneration subject. Furthermore, the Parliament requests that the names of the enterprises who do not act in compliance with these rules are made public and that the Commission and member states build a common system to register the remuneration of individuals earning more than € 1 million. The Commission is also

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[34] For instance according to Arlene McCarthy (Press release, Euro MP Urges Parliament to End Bankers' Discredited Bonus Culture, 6 July 2010) and Corien Wortmann (Press release, EU stelt strenge eisen aan Europese bankbonussen, 6 July 2010), members of the European Parliament, or according to the website of the European Parliament: http://www.europarl.europa.eu/news/expert/infopress_page/042-77286-181-06-27-907-20100630IPR77285-30-06-2010-2010-false/default_en.htm.

[35] 2010/2009(INI), Rapporteur: Saïd El Khadraoui.

asked to clarify the position of supervisory authorities when it comes to remuneration, to strengthen the role of non-executives and to ensure that when the subject is regulated, fundamental rights – such as the rights of social partners – to conclude and enforce collective agreements are respected.

IV. Dutch Rules

The Netherlands seem to be one of the front runners when it comes to the implementation of the European recommendations on remuneration.[36] This is an indication that the subject is taken seriously in the Netherlands, as these recommendations do not have to be implemented due to their non-binding nature.

The Netherlands regulate the subject in legislation, regulations and rules.[37] These are either binding or non-binding. The binding rules can be found in (i) the second book of the Dutch Civil Code (the "**DCC**"),[38] (ii) the fiscal legislation on the extra taxation of excessive remuneration,[39] (iii) the statutory provision on works councils,[40] (iv) the provision on financial supervision[41] and (v) the Dutch corporate governance Codes. The first four sets of binding rules are regulated in legislation and seem negligible, whereas the Dutch corporate governance Codes can be found in self-regulation which has been embedded in a statute. The Dutch corporate governance Codes are the Frijns Code and the Banking Code. Both Codes have elaborate rules on remuneration and a few noteworthy provisions. The claw back provision was for instance introduced for the first time in the Netherlands in the Frijns Code. This provision makes it possible to reclaim or adjust variable remuneration which was granted based

36 See the two analyses of the implementation of the two recommendations COM(2010) 285 final and COM(2010) 286 final. Unfortunately, the CEBS has not published any information which can be retraced to a specific country in its' report on national implementation of CEBS High-level Principles for Remuneration Policies, 11 June 2010.

37 For an extensive discussion of the different rules, see parliamentary paper 31 980 nr. 6.

38 Book 2 of the Dutch Civil Code contains the statutory provisions on the different Dutch juristic persons. Among others, it contains provisions on the remuneration of directors for the private and the public limited liability companies (articles 2:135 and 2:245 DCC). The disclosure of the remuneration is also regulated for the other juristic persons (articles 2:383-2:383e, 2:396 paragraph 5 DCC).

39 *Wet belastingheffing excessieve beloningsbestanddelen*, parliamentary paper 31459.

40 *Wet op de ondernemingsraden.*

41 According to the minister of finance (), the remuneration subject is regulated in the Financial Supervision Act (Wet financieel toezicht).

on wrong (financial) information. The Banking Code has introduced two concrete requirements as to the height of the variable remuneration. First is the cap on individual board members remuneration. This cap limits the variable to fixed remuneration ratio to 100%, meaning that the variable remuneration cannot amount to more than 50% of total remuneration. In the Netherlands, there were examples of employees (thus not board members) receiving ratios of 354% in 2007 and 311% in 2008.[42] The second measure is that the total board member remuneration should not only be compared to (the median[43] of) remunerations of functions within and outside the financial world, but also to the (relevant) international context.[44] The median will be determined by analysing the remuneration of relevant peer groups based on functions and enterprises.[45] According to the government, the obligation of having to be in line with the median of remuneration means that a cap is put on the remuneration of board members which is said to be unique in the world.[46]

Although the Frijns Code and the Banking Code are binding, they are not mandatory. They either work with the 'apply or explain' or 'comply or explain'[47] principle, meaning that enterprises are allowed to deviate from the best practice provisions if the deviation is explained. There are plans of embedding the claw back provision[48] in the Financial Supervision Act (the "FSA") and in the DCC.[49] A statutory embedment is necessary as it would make the provision mandatory. Under the Frijns Code, it would probably be necessary to incorporate a clause in the employment contract for the claw back to be enforceable.

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42 De Nederlandsche Bank, "Naar een beheerst beloningsbeleid", Rapportage van het onderzoek naar de beloningssituatie bij Nederlandse financiële ondernemingen, September 2009.

43 The median being the middle measured value of the different measurements of a benchmark group. See J. Otten and J. H. van Oosterhout, Bestuurdersbeloning; Ideologie, Symboliek of Instrument van corporate governance? Ondernemingsrecht 2008, 84, p. 294.

44 Article 6.3.1. Bank Code.

45 Parliamentary paper 31 371 nr. 284.

46 Parliamentary paper 31 371 nr. 284.

47 'Apply or explain' is the translation of the Dutch principle '*pas toe of leg uit*'. This principle was used in the Tabaksblat Code, which is the predecessor of the Frijns Code. In the Frijns Code, the words 'pas toe of leg uit' cannot be found, but the principle remains the same, as the Code explicitly states that enterprises are allowed to deviate from the best practice provisions but reasons have to be given for the deviation. The Banking Code also uses the principle 'pas toe of leg uit', but in the English version it chooses to translate the principle by 'comply or explain'.

48 Parliamentary paper 32 036, nr. 12

49 *Concept Wijziging van* de wet op het financieel toeticht ter introductie van claw back en redelijkheids- en billijkheidstoets, dated 9 April 2010.

50 Letter minister of finance to the Parliament, dated March 31st 2009, Akkoord financiële sector.

There are also two non-binding reports and gentlemen's agreements which can be qualified as rules of corporate governance. Unlike the official corporate governance Codes, these non-binding documents exclusively focus on financial institutions. The first non-binding Code is a gentlemen's agreement between the Minister of Finance and the financial industry (the "**Gentlemen's agreement**").[50] The second one is a Code of Principles formulated by two Dutch supervisors: the Financial Markets Authority (FMA) and the Dutch National Bank (DNB) (the "**FMA/DNB Principles**").[51] The Principles have no legal status yet[52] since the FMA does not have the authority to uphold the Principles and it is unclear whether DNB has the authority to do so.[53] Financial institutions should therefore follow the Principles as a guide. The Principles will be embedded in legislation so that the FMA receives an applicable and concrete connecting factor to uphold the Principles.[54] At this moment, the minister of Finance is consulting the market to see whether the Principles could be implemented through the Decree sound remuneration policies (*besluit beheerst beloningbeleid*, the "**bbb**").[55] If these Principles are implemented, this would mean that this set of rules will become the first full-fledged set of binding and mandatory rules on remuneration in the Netherlands. This embedment however does not mean that the two supervisors can take action against variable remuneration as such. The supervisors will only have the authority to act if remuneration incentives (could) lead to taking irresponsible risks or to careless dealing with clients.[56]

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51 The FMA is responsible for the supervision on prudent provision of services and DNB for the controlled conduct of business of banks.

52 N. Veldhoven and M.F. Landkroon, Principes voor beheerst beloningsbeleid: mooi in theorie én in de praktijk? V&O 2009, p. 127.

53 According to the minister of finance, the remuneration problematic falls under the scope of the supervision of DNB since it would fall under the rules of prudent conduct of business (Financial Supervision Act), parliamentary paper 31 371 nr. 284.

54 The embedding will take place in the Besluit gedragstoezicht financiële ondernemingen Wft and the Besluit prudentiële regels Wft, parliamentary paper 32 013, nr. 6.

55 Letter of the minister of finance to the second chamber of the Parliament, dated 18 may 2010 (Implementie van de hervormingen in de financiële sector).

56 R. Wibier and R Labeur, Kroniek van het financiële recht, Nederlands Juristenblad, 16 04 2010, issue 15, p. 1011.

57 However, the Frijns Code does not regulate all listed companies. The Frijns Code applies to (i) all companies who have a registered office in the Netherlands and whose shares or depositary receipts for shares are admitted to listing on the stock exchange or a comparable system, and (ii) all large companies with registered office in the Netherlands (balance sheet value > € 500 million) whose shares or depositary receipts for shares are admitted to trading on a multilateral trading facility or a comparable system.

Why are there so many different rules? Would one set of rules not be sufficient? The main reason is simple: they regulate different types of enterprises. The Frijns Code regulates listed companies only,[57] whereas the Banking Code regulates the banking sector exclusively. A listed bank such as ING falls under the Frijns Code and the Banking Code. In contrast, a non-listed bank such as the Rabobank only falls under the scope of the Banking Code. The third category of enterprises – namely non-listed enterprises and small financial institutions not being banks – are not regulated by the Banking Code nor the Frijns Code. The Gentlemen's agreement and the FMA/DNB Principles regulate the whole financial industry and would therefore regulate such institutions. The necessity to have the Frijns Code and the Banking Code while the Gentlemen's agreement and the FMA/DNB Principles already apply to all financial institutions is explained by the fact that the Gentlemen's agreement and the FMA/DNB Principles are non-binding whereas the two Codes are.

In September 2009, DNB published a report on remuneration at financial institutions.[58] In this report, DNB published some research it had conducted in the period April and May 2009 over the period 2007-2008. DNB concluded that the risks attached to remuneration policy and more specifically to (variable) remuneration were not sufficiently controlled by the enterprises. Remarkably enough, the financial institutions indicated that they believed they were already complying for the greatest part with the Principles. DNB therefore came with a few suggestions in its report on how to improve the FMA/DNB Principles for sound remuneration. DNB named these suggestions the 'good practices'.

In the beginning of 2010, the special committee of inquiry into the financial crisis analysed the different rules on remuneration and concluded that there was still some room for improvement. The Committee puts the responsibility mostly on the financial institutions, but to a lesser extent also on the legislator and the supervisor. Recommendation 4, 5 and 8 concern the remuneration directly. The committee believes that the banking code should be adapted and extended. For instance, (i) the provisions of the code should not apply to the remuneration of board members only, but to the remuneration of all employees, (ii) retention, exit and welcome packages should be restricted if they have perverse incentives, (iii) restriction of the variable remuneration should not lead to excesses in

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[58] De Nederlandsche Bank, "Naar een beheerst beloningsbeleid", Rapportage van het onderzoek naar de beloningssituatie bij Nederlandse financiële ondernemingen, September 2009.

the fixed remuneration, (iv) there needs to be a balanced relationship between the different levels of remuneration within the enterprise, which does not lead to perverse incentives. The starting point should be: no profit, no bonus, and (v) the remuneration framework should be explicit and transparent, so that a financial institution can be addressed and judged on it. In case the financial institution receives state aid, the committee advises that: (i) the consequences for board member remuneration should be identical to the bankruptcy situation: all 'future' variable remuneration will revert, (ii) the supervisory board should see if it is possible to claw back bonuses paid out in the past, and (iii) the scope of this recommendation should also, if possible, be extended to the whole organisation (thus not only to board member remuneration). Last but not least, the committee believes that all her recommendations should also apply to other financial institutions than banks, especially for the remuneration issue.

V. Issues

Since the beginning of the credit crisis, many developments have taken place in the field of remuneration.[59] On a European level binding rules have recently been adopted and in the Netherlands some new binding rules have been or are in the process of being adopted. However, these rules are not always clear-cut and raise some questions. In this article, we are not aiming at giving a full overview of the issues, but are describing two issues we believe are worth mentioning and discussing.

A. Regulating variable remuneration on a European Level?

First, the question is raised on what level the subject should be regulated. As most financial enterprises operate cross borders, the subject should be regulated internationally.[60] In that way, enterprises will be confronted with similar requirements in the different countries they operate in. The subject should also be regulated on an international level because else it could trigger a ratrace: enterprises will receive incentives to leave countries in which the rules are considered to be too strict.[61]

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[59] Compare for instance the description in the De Wit report (parliamentary paper 31 980 nr. 6.) of the remuneration rules and their shortcomings and the rules described in this article.

[60] This was recognised by the G20. The G20 therefore committed itself to the FSF Principles (Financial Stability Forum, FSF Principles for sound compensation practices, 2 April 2009) and the FSB implementation standards (Financial Stability Board, FSB Principles for sound compensation practices – implementation standards, 25 September 2009.)

An example of such discrepancy, is the severity between the European and the Dutch rules on state intervention. CRD III regulates the remuneration in the situation that a financial institution should benefit from a government intervention. The European rules do not forbid the payment of variable remuneration in this situation but they restrain it. Directors are only allowed to receive variable remuneration if it is justified, variable remuneration should be limited as a percentage of net revenues but only in the situation that it is "inconsistent with the maintenance of a sound capital base and timely exit from government support" and finally the credit institution will need to restructure its compensation systems so that they are aligned with sound risk management and long-term growth. This would amongst others mean that – if it is appropriate – the remuneration of board members should be limited. These European rules leave a lot of room for interpretation.

In the Netherlands, the subject is not regulated in legislation, but the minister of finance has announced that he will set strict requirements to financial institutions if they knock on his door for help.[62] The minister believes that the situation in which the state has to intervene, is so serious that the consequences for the remuneration of the board members should be the same as they would be in a bankruptcy situation. In the past, whenever granting state aid to financial situations, the minister had set a few conditions as to the remuneration, such as that the institution should draw up a new and sustainable remuneration policy for the board and senior management, that the board members should renounce their bonuses for a certain period and that the severance pay should not amount to more than one year of fixed remuneration.[63] The minister would like to add to these conditions that all outstanding rights on variable remuneration become invalid, meaning that all shares, option rights or reserved cash bonuses would flow back to the institution. On top of this, he will ask the supervisory board to check whether it is possible to claw back variable remuneration which has been paid in the past. By setting these requirements, the Dutch government regulates the subject through contracts rather than through legislation.

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[61] See parliamentary paper 31 980 nr. 6.

[62] Letter of the minister of finance to the second chamber of Parliament, Maatregelen financiële sector korte termijn, 7 april 2010. Also see Parliamentary paper 31 980 nr. 4, p. 15.

[63] Letter of the minister of finance to the second chamber of Parliament, Maatregelen financiële sector korte termijn, 7 april 2010 and V.P.G. de Serière, Het beloningsbeleid bij financiële instellingen, Ondernemingsrecht 2009, nr. 100.

The Dutch solution as to the problem what happens to variable remuneration when governments intervene financially is by far stricter than the European rules and leaves less room for interpretation. The Dutch solution gives a better incentive to employees as to prevent the need of government intervention and would probably be better accepted by society. Furthermore, the timing of the Dutch solution seems to be more 'convenient' as it is a severe requirement: if it is not fulfilled, then no financial aid is given, whereas the consequence of not obeying the European rules does not seem as severe. Hypothetically, this could mean that as the European rules are less strict than the Dutch rules, institutions would leave the Netherlands to move to another European country.

This argument tends to favour the 'international' approach: regulate the remuneration subject on an international level. However, different corporate governance models such as the shareholders and the stakeholders model can clash on this point. In the stakeholders model, which is the applicable model in the Netherlands,[64] the task of the board is to act in the interest of the enterprise,[65] thus in the interest of all stakeholders. In this system, it seems to be inconsistent to award variable remuneration based on shareholders' value – a tool to promote the interests of only one of the stakeholders.[66] Shareholder interests do not have to coincide with the interests of the enterprise. For ex-

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[64] See C.W. de Monchy, Actualiteiten corporate governance, Ondernemingsrecht 2007, nr. 120, p. 414 and P.A.M. Witteveen, De SER, de medezeggenschap en evenwichtig ondernemingsbestuur, Ondernemingsrecht 2008, nr. 64. Anglosaxon countries tend to use the shareholders model over the stakeholders model. In the shareholders model, as the Hampel report formulated, the board members are "responsible for relations with stakeholders; but they are accountable to the shareholders". Committee on corporate governance, Final Report, January 1998 (Hampel Report), par. 1.17. P. van Schilfgaarde and J. Winter, Van de BV en de NV, Deventer: Kluwer 2009, p. 26.

[65] P. van Schilfgaarde and J. Winter, Van de BV en de NV, Deventer: Kluwer 2009, p. 150 and B.T.M. Steins Bisschop, Beloningssystemen: de ongerechtvaardigde hypothese van parallelle belangen tussen aandeelhouders en bestuurders, Tijdschrift voor Ondernemingsbestuur 2006, p. 55.

[66] Of course not all shareholders have the same interests and goals. For instance, the hedge fund trader or the pension funds are likely not to have the same interest. The latter probably having a long term interest and/or goal. In the doctrine, it is sometimes argued that the criterion of long term shareholders value cannot really be distinguished from the criterion of the interest of the enterprise. See G.T.M.J. Raaijmakers, De financiële markt en het ondernemingsrecht, Ondernemingsrecht 2009, nr. 104, p. 430-441 and the there in named literature references. If that view is followed, it can be justified to follow the interests of one of the stakeholders – namely the long term shareholders – since their interests and goals would be the same as the interest and goals of the enterprise.

ample creditors are said to have long-term interests as they want their deposits and mature debts to be repaid, whereas shareholders have mostly short term interests: they want the share prize to rise a maximisation of profits on the short run.[67]

This raises the question whether the remuneration subject can be regulated on a European level, as the European rules should take into account both the shareholders and the stakeholders model. Unlike the post credit crunch rules in the Netherlands, where the focus has been put on returning to a system in which remuneration systems stimulate the stakeholders model, the European model seems to focus more on the shareholders model. For instance in the De Larosière report,[68] it is explicitly stated that the remuneration incentives should be re-aligned with shareholders interests and CRD III requires that at least 50% of the variable remuneration should be paid out in shares or similar non-liquid instruments.

It would go beyond the scope of this article to analyse the consequences of shareholders value based variable remuneration for the stakeholders model or even be a subject more appropriate for an economic analysis, but it is important to keep this point in mind as it is arguable that the subject cannot be regulated on a European level as both systems seem to clash on this point.

This point can be nuanced somehow though, since the shareholder model and the stakeholder model seem to be becoming more similar. For instance, in article 172 of the UK Companies Act 2006, the director is given the task to act in a way in which it is most likely that he or she will promote the success of the company as a whole. In this, the director needs to pay particular attention to the long term consequences, the interests of the employees, the relationships with suppliers and customers, the impact of its acts on the community and the environment, etc. This seems to mean that the UK shareholder model has incorporated stakeholder elements in its system. On the other hand, Timmerman[69] argues that the Dutch stakeholder model seems to have incorporated some share-

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[67] COM (2010) 284 final, p. 4.

[68] High Level Group on financial supervision, Report, 25 February 2009, point 118.

[69] L, Timmerman, Grondslagen van geldend ondernemingsrecht, Ondernemingsrecht 2009-1, p. 8-9. H.J. de Kluiver, Vennootschappelijke repliek op Timmerman's grondslagen, Ondernemingsrecht2009-1, p. 19 however doesn't agree with Timmerman that long term shareholder value is a better guideline than the interests of the company and its enterprise (this criterion reflects the interests of all the stakeholders).

holder model elements in its system. One of the reproaches made to the Dutch disproportionally increased in comparison with the power of other stakeholders. This made it more difficult for banks to develop a sustainable and on long term focussed company strategy due to the enforced role of the short term interests of shareholders.[70] The Frijns Code, which was adopted after the beginning of the credit crisis, did not come back on the tendency to focus more on the interest of the shareholder but has embraced the principle that companies should endeavour to create long-term shareholder value.

On this note, we think that if the remuneration incentives should be realigned with shareholders interests, these interests should be the long term shareholders interests. Next to that the interests of other stakeholders should be taken into account. If remuneration incentives are applied to financial institutions it is especially important to align these incentives also with the interests of the non-shareholding stakeholders.

B. To have concrete rules or not to have concrete rules

The 50% rule is not the only concrete rule that was introduced in CRD III. It also contains concrete percentages regulating what amount of the variable remuneration should be deferred. On a Dutch level, the Banking Code contains two concrete measures which on the one hand regulate the height of the total remuneration and on the other the ratio of variable to fixed remuneration. These concrete measures do not coincide with each other: the European fixed percentages do not regulate the same subjects as the Dutch concrete measures. This raises the questions when do you choose to introduce a concrete rule instead of a vague norm and why do the European and Dutch rules differ on these points?

A frequently used argument for not regulating the remuneration subject in legislation is that it cannot be regulated in that way because all institutions are different and that the same rules can therefore not apply to different institutions. This argument is also used against concrete rules.[71] This argument has some truth to it, as the size and type of financial institutions should play a role when setting the remuneration policies. However, the problem of vague rules is that

[70] Rapport Commissie Maas, Naar herstel van vertrouwen, 7 April 2009, p. 21.

[71] For example see Financial Services Authority, Reforming remuneration practices in financial services, Feedback on CP09/10 and final rules, August 2009.

there is a lot of room for interpretation. The European Commission considers that one of the corporate governance problems as to financial institutions and the credit crisis is that the existing corporate governance principles are too broad in scope and not sufficiently precise.[72] An example of a vague rule is also found in CRD III: institutions are responsible for setting appropriate ratios between the variable and fixed remuneration. What is an appropriate ratio? Who will set such ratio? Will different institutions set their ratios differently because they weigh (the same) risks differently? Could an appropriate ratio therefore be 50% for one institution and 200% for another one? CRD III gives the Committee of European Banking Supervisors (the "**CEBS**") the task to come up with guidelines which will set specific criteria to decide what an appropriate ratio is. Time will tell what CEBS considers to be an 'appropriate' balance and whether CEBS will differentiate for different types and/or sizes. The Banking Code partially solves these issues by stating that the ratio cannot go beyond 100%. The task of the authors of the Banking Code however was slightly easier, as it was limited to one type of enterprise, namely banks.

We believe it should be possible to regulate certain boundaries in percentages, as percentages fix the structure of the remuneration and its incentives. By stating that the variable remuneration can not be more than the fixed remuneration, it should not contain too many restrictions for financial institutions to fix their own policies. The percentages should however not leave room for interpretation, such as the 40/60% rule of CRD III. This rule states that the deferred portion of the variable remuneration should not come below 40%, or 60% when the variable remuneration is particularly high. It goes without saying that it is unclear when the 60% rule should kick in. Another example of a concrete 'rule' giving some interpretation problems is the 30% capped upfront cash remuneration which could allegedly be deducted from CRD III. As explained in the paragraph on European rules, some interpret the 50% rule of variable remuneration that has to be paid in shares or similar instruments together with the rule stating that 40/60% of variable remuneration should be deferred as meaning that maximally 30% of the variable remuneration can be paid in upfront cash. However, if the 50% rule is read, there seems to be no support for this interpretation. The first sentence starts of by stating that "a substantial portion, which is at least 50 % of any variable remuneration shall consist [...]". If this sentence is read, then it is unclear where the division in deferred and non-

[72] COM (2010) 284 final, p. 6.

deferred comes from. The rule states that 50% of any variable remuneration should be paid in diverse instruments. By formulating the rule in such way, the legislator could refer to (i) the situation when there is a variable remuneration, thus opposed to the situation in which there is no variable remuneration, or (ii) if other articles are taken into account that speak of "the variable remuneration component", to the situation that indeed a division is meant, but it could be a division of choice. For instance, the variable remuneration could be divided into different sorts of variable remuneration, such as remuneration that is linked to customer satisfaction and employee satisfaction. Therefore, based on the text of the rule, there is no reason to interpret it as meaning that 50% of the deferred and 50% of the non-deferred part of the variable remuneration should be paid out in shares or share linked instruments. The 40/60% rule comes after this rule, and is the first rule in which the distinction deferred/non-deferred is actually made.

A problem attached to setting concrete measures, is that maximum or minimum boundaries tend to become the norm instead of a real maximum or minimum. Enterprises should be stimulated to reflect on the question whether the maximum or minimum is also appropriate for their business. This could be done by askin.g enterprises to explain their policy on this matter, for example in the annual report and asking them to perform peer group comparisons.

VI. Conclusion

Although the G20 has cried out that reforms of the remuneration system should be done on a global scale and in a certain way uniformly,[73] the question can be asked whether it is possible to regulate such a subject uniformly when countries that should adopt these rules have clashing corporate governance models. We think that in the long run this problem can be solved because the shareholder model and the stakeholder model are becoming more and more similar. The enlightened shareholders model which is incorporated in the UK Companies Act also takes into account the interests of some non shareholding stakeholders while in the Dutch stakeholder model more emphasis is laid on the

[73] The G20 therefore committed itself to the FSF Principles (Financial Stability Forum, FSF Principles for sound compensation practices, 2 April 2009) and the FSB implementation standards (Financial Stability Board, FSB Principles for sound compensation practices – implementation standards, 25 September 2009.)

long term shareholders interests. In the short run this problem can and should be solved for financial institutions. To prevent another financial crisis it should be accepted that the variable remuneration of financial institutions will not predominantly be done in shares or similar instruments, as, due to the systemic risk, financial institutions form a special category of enterprises who have society as one of their important stakeholders.

The different rules contain diverse fixed norms, varying from fixing the ratio of the variable to fixed remuneration to prescribing that 50% of the variable remuneration should be paid out in shares or similar instruments. But as financial institutions vary in size and types, it is often stated that no (concrete) rules can be adopted on the remuneration subject. In this article we defend that it is possible to set some fixed boundaries (in percentages), as these fix the remuneration structure, being one of the causes of the credit crisis. However, the danger always exists that when setting maximum and minimum boundaries, they become the norm. Financial institutions should be encouraged to reflect on whether these boundaries should become the norm for that particular institution. This could be encouraged by asking the institution to explain its policy, for example in the annual accounts and by performing peer group comparisons.