

# INFORMATIVE NOTE



## CORPORATE GOVERNANCE

# CORPORATE GOVERNANCE: NEWS IN REMUNERATION MATTERS

In the Portuguese jurisdiction, one highlights the recent approval of Law 28/2009 which establishes binding obligations.

Corporate governance has been in the public eye over the last years, both in national and international *fora*. In general, news rules are intended to create conditions for a better management and performance of economical players. Within the core matters of corporate governance, remuneration policies and its level of disclosure have been under permanent discussion.

Due to the current financial environment, both at national and communitarian levels, several regulations – including, binding rules and recommendations, some further detailed than others – have been passed aiming to improve the legal framework on corporate governance.

### NEW REMUNERATION RULES (IN GENERAL)

#### I. NATIONAL PROVISIONS

In the Portuguese jurisdiction, one highlights the recent approval of Law 28/2009<sup>1</sup> which establishes binding obligations.

As to its scope, these new rules cover a broad range of entities: all public interest entities<sup>2</sup> (for instance, issuers of securities admitted to trading on a regulated market, credit institutions obliged to statutory auditing, real estate and investment funds, venture capital companies and funds) as well as financial companies, managing companies of venture capital funds and pension funds.

Under Law 28/2009, the management

body<sup>3</sup> annually submits to the approval of the general shareholders meeting a statement on the remuneration policy of the members of the management and supervisory bodies.

On the other hand, the above mentioned entities shall annually disclose the remuneration policy of such corporate bodies approved by the general shareholders meeting as well as the annual remuneration paid to its members, on an aggregated and individual basis.

The breach of the above mentioned obligations leads to the application of particular heavy fines. For instance, public companies with securities admitted to trading on a regulated market might be subject to fines ranging between € 25,000 and € 5,000,000.

According to its Activities Plan, also CMVM<sup>4</sup> will revise the Recommendations on Corporate Governance applicable to listed companies during 2009. An amendment to remuneration rules is

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<sup>1</sup> Law no. 28/2009 of 19 June, on remuneration disclosure and policy in force since last 20 June.

<sup>2</sup> As listed in Decree-Law no. 225/2008, of 20 November.

<sup>3</sup> Or the Remuneration Committee, when applicable.

<sup>4</sup> Comissão do Mercado de Valores Mobiliários, The Portuguese Securities Exchange Commission.

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expected, considering the recent EC recommendations. By its turn, IPCG<sup>5</sup> has submitted to public consultation a Draft of Corporate Governance Code, being the adoption of new guidance on remunerations expected.

## II. EC PROVISIONS

Following previous Recommendations<sup>6</sup>, the European Commission (EC) approved last April, a Recommendation on the regime of the remuneration of directors of listed companies<sup>7</sup>.

Such Recommendation envisages, among others, that directors' remuneration structure promotes the long term sustainability of the companies, being based on performance criteria. Consequently, in what concerns to the variable components of the remuneration, their link to pre-established and measurable criteria is recommended. Additionally, they shall be subject to limits and deferred for a certain period, being the companies entitled to reclaim them if they were paid on the basis of data which proved to be manifestly misstated.

On the other hand, the removal of the so-called "golden parachutes" is intended. Its purpose is to avoid implementing termination payments in case of discharge that could lead to a reward by an inadequate performance.

In what respects to the components of remuneration in shares, share options or any other right to acquire shares or to be remunerated on the basis of share price movement, they shall be attributed essentially on the basis of the performance and of the creation of long-term value.

In addition, the strengthening of the liability of the management boards is intended, being the shareholders – *maxime* the institutional – encouraged to exercise their voting rights in the shareholders general meetings on these matters. Further developing of remuneration committees' competences and function is also envisaged<sup>8</sup>.

## NEW REMUNERATION RULES FOR THE FINANCIAL SECTOR

### I. NATIONAL PROVISIONS

The most recent legal measures on corporate governance of the credit institutions and financial companies do not include rules on remuneration: they are limited to matters such as the supervision and the governance models of the public interest entities<sup>9</sup> as well as to the composition of the supervisory and management bodies<sup>10</sup>.

Nonetheless, in the scope of guarantee concession by the State<sup>11</sup>, it was set forth that *"in case of activation of a guarantee following default by the beneficiary entity"*, the State may, among others, *"decide on the adoption of principles of corporate governance, on the dividends distribution policy and on the remuneration policy of the management and supervisory bodies' members"* of the beneficiary of the guarantee<sup>12</sup>.

On its turn, measures fostering financial strengthening also foresee rules on remuneration applicable to public investment beneficiary entities<sup>13</sup>. Further them, the application for such purpose leads to, *grosso modo*, the

disclosure of the remuneration policy for the management and supervisory bodies, the approval of the remuneration policy by the general shareholders meeting, the adoption of principles of corporate governance, the disclosure of the individual remuneration (fixed and variable) of the members of the management and supervisory bodies, as well as the remuneration thresholds.

## II. EC PROVISIONS

A draft for the amendment of the Capital Requirements Directive<sup>14</sup> (applicable, in general terms, to credit institutions) was recently submitted to public consultation<sup>15</sup>.

Within the matters subject to amendment, one emphasizes rules attempting to promote the coherence between the remuneration policies and an efficient risk management, the inclusion of the remuneration policies and practices in the Supervisory Pillar<sup>16</sup> and the aggravation of the fines.

In the recommendatory field, the EC Recommendation on remuneration policies in the financial services sector, applicable to all financial institutions, shall be highlighted<sup>17</sup>.

Its biggest particularity *vis-à-vis* the Recommendation on remuneration of directors of listed companies consists on the direct connection and necessary coherence that shall be established between the remuneration policy's structure and content and the efficient and solid risk management, not entailing excessive risk exposure. This purpose does not conflict with the establishment of a remuneration policy aligned with the strategies, values and long term interests of the financial institutions as well as with clients and investors' protection.

Besides this, in general, the rationale behind this recommendation is similar to that reflected in the EC recommendation on the remuneration of the directors of listed companies.

<sup>5</sup> Instituto Português de Corporate Governance, the Corporate Governance Portuguese Institute.

<sup>6</sup> Recommendation 2004/913/EC of 14.12.2004 fostering an appropriate regime for the remuneration of directors of listed companies and Recommendation 2005/162/EC of 15.02.2005, on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

<sup>7</sup> Recommendation 2009/385/EC of 30.04.2009. Member States are invited to take the necessary measures to promote the application of this Recommendation by 31 December 2009.

<sup>8</sup> Firstly accommodated in Recommendation 2005/162/EC of 15.02.2005, above referred.

<sup>9</sup> See Decree-Law no. 225/2008 of 20 November.

<sup>10</sup> See Decree-Law no. 126/2008 of 21 July which has amended the Legal Framework of Credit Institutions and Financial Companies. Moreover, the Bank of Portugal has recently approved a Circular Letter no. 24/2009/DSB of 27 February, 2009, namely related with the independence requirements on the management and supervisory bodies of the credit institutions.

<sup>11</sup> See Law no. 60-A/2008 of 20 October (developed by Order no. 1219- A/2008, of 23 October).

<sup>12</sup> See article 10(b) of the Order referred in the previous footnote.

<sup>13</sup> See Law no. 63-A/2008 of 24 November, developed by Order no. 493-A/2009 of 8 May.

<sup>14</sup> Directive 2006/48/EC, of 14.06.2006.

<sup>15</sup> This public consultation has taken place between 29 April and 6 May 2009.

<sup>16</sup> Pillar II (Supervision) Basel II.

<sup>17</sup> Recommendation 2009/384/EC, approved last 30 April 2009.

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## FINAL REMARKS

New rules on corporate governance are still expected in a near future. For instance, Directive 2006/46/EC (related to *inter alia* the annual corporate governance report) has not been implemented yet, the same for the shareholders' rights Directive<sup>18</sup> (estimated to occur during the summer).

Considering the current context and the measures that have already been taken, mainly concerning to disclosure duties

and shareholders supervision, new rules on remuneration matters are likely to deal with substantive matters, such as limits to the remuneration structure and components, in particular by reference to risk management and performance.

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<sup>18</sup> Directive 2007/36/EC of 11.06.2007 on the exercise of certain shareholders' rights on listed companies.

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