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FÖR SVENSK BOLAGSSTYRNING

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Enheten för fastighetsrätt och associationsrätt / Division for Real Estate and Company Law
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Re. recommendation on director and executive remuneration

The Swedish Corporate Governance Board, (the Board), has been invited to comment on a recommendation from the European Commission regarding remuneration of directors and executives. This recommendation would replace the Commission's existing recommendation, which was issued in 2004. The comments below are based on a statement by the European Corporate Governance Forum (EUCGF) issued on 24 March 2009, which raises issues which the EUCGF feels should be regulated through directives and those which it recommends be included in the recommendation. As it is not yet known how the Commission will draw the line between these two, the board has provided comments on the whole of the EUCGF statement.

We would like to point out that the limited time available, which moreover largely coincided with the Easter weekend, has made a thorough examination of all the issues impossible. This reply has therefore been written mainly by the Board Secretary, who has not been able to discuss the issues with the entire Board.

General points

EUCGF's statement reflects the current tone of the debate within the EU on remuneration of directors and executives in the private business sector. The Board sees a risk that the current climate will lead to far-reaching and detailed regulation of these issues, which is not beneficial in the long run to the companies concerned, their shareholders or society as a whole. The remuneration of directors and senior executives is a vital component in the competition between companies for the most competent people. There is a risk of economic sub-optimisation if such competition is removed or seriously impeded by limiting the scope to design remunerations systems according to the individual circumstances of each company. Before extensive and more or less mandatory regulation of these issues is introduced throughout the EU, the Board feels that there should be more time for reflection, analysis and consultation.

The Board would also like to underline the significant differences between the corporate legislation of different EU member states, as well as between corporate governance traditions and accepted practice. These mean that the problems can be very different in different parts of the Union. While there have without doubt been a number of excessive and inappropriately designed remunerations systems in Sweden, the problems have not been comparable with those in certain other member states, either in their scope or prevalence. When the Commission attempts to rectify these problems on the basis of the most extreme cases, it risks imposing more far-reaching and restrictive regulation on certain member states than is justified by these countries' own experiences.

The Board therefore doubts the necessity of implementing large parts of this regulation in the form of mandatory directives, preferring recommendation as the main method of regulation of these issues. If directives are found to be the only feasible form of regulation, however, the Board is of the opinion that the directives should give the greatest possible scope for implementation through self-regulation in member states where there are well-functioning systems for this.

As well as certain general issues in points 1-4, the EUCGF statement mainly considers three areas:
- *Disclosure* of remuneration of boards and executive management (point 5).
- *Decision processes* for setting executive pay and the role of shareholders in this process (point 6).
- *Content and form* of director and executive pay (point 7).

Each of these areas is commented upon separately below.

Disclosure of remuneration of boards and executive management

In Sweden, these issues have been regulated by legislation since 2006, when the Swedish Code of Corporate Governance rules regarding information on principles for remunerations set by shareholders' meetings and a previous recommendation from the Swedish Industry and Commerce Stock Exchange Committee on information on executive pay were included in the revised Companies Act. The ongoing committee study of how rules for small businesses can be simplified has since been asked to consider the possibility of making these rules part of the self-regulation system again, and sources have indicated that the committee will make a formal proposal on this.

The Board is positive to returning these rules to the self regulation process, and would be prepared to reintroduce such rules into the Code. This would not be possible, however, if the EUCGF proposal to regulate such issues in the form of directives for implementation through mandatory legislation were accepted. The Board therefore recommends that the issue be regulated in a recommendation for implementation in the form of self regulation. The second best alternative would be to allow the possibility of implementation through self regulation if regulation occurs through directives.

In this context, the board would like to underline the importance of a clear definition of which positions would be covered by the disclosure rules concerning individual remunerations. Swedish legislation on this issue covers members of the company board and the chief executive officer, (CEO), but not executives that report to the CEO. This corresponds to the English language term "executive and non-executive directors", which for stock exchange listed companies in Sweden means board members and, where applicable, the CEO or any other employee who is a member of the board. In the Anglo-Saxon corporate governance system, this group also includes a number of other members of the executive management, known as "executive directors". It is vital that the rules in any directives on this issue are not written in such a way that employees reporting to the CEO are included in the requirement to report individual remunerations. Such a requirement was considered when the current Swedish legislation was being introduced, but was found inappropriate for a number of reasons, e.g. that it would probably lead to inflated salary levels. The Board shares this view, and is strongly opposed to an expansion of the requirement to report individual remunerations to include employees subordinate to the CEO.

Decision processes for setting executive pay

The main content of this point is largely already applied in Sweden, either through the Code or legislation:

- That only non-executive directors are to participate in decisions regarding remuneration of the executive management of the company is covered by the code rule on remuneration committees.
- That shareholders are given the opportunity to vote on guidelines for executive pay at shareholders' meetings has been regulated by the Companies Act since 2006.
- That the shareholders' meeting is to decide on share-related incentive programmes for the board is a consequence of the Companies Act's stipulation that the shareholders' meeting decides on all remunerations to the board.

The EUCGF also recommends regulation in the form of directives on this point, but feels it should be possible to implement the rules through self regulation. The Board supports this, but would prefer to see that these issues be regulated through recommendation.

Content and form of director and executive pay

The EUCGF begins this section by stating that the content of board and executive remuneration should not be subject to mandatory regulation by the EU, and it should be left to companies and their owners to devise systems to suit their own circumstances. The forum then goes on to say that there is a need to define general best practices to avoid systems that may be counterproductive for companies and gives a number of relatively detailed guidelines for how systems should be designed to avoid this. It suggests that these guidelines take the form of a recommendation, requiring each point to be included in national corporate governance codes.

The Board shares the opinion that these issues should be left to individual companies, but feels that this is also the case for the guidelines the EUCGF suggests be incorporated in national codes. Most of these are fairly obvious and should already be applied by well run companies, but in many cases they are quite detailed and may be unsuitable for individual companies. The Board does not feel, therefore, that a recommendation that these points be incorporated into national codes is justified.

Should the Commission decide to issue a recommendation in line with the EUCGF proposals, the Board would like to emphasise certain points that are particularly questionable.

- The second indent states that flexible remunerations should be linked to factors that represent "real growth of the company…" There can be many stages in the development of a company where growth is not a main priority compared with, for example, improved profitability. Furthermore, growth is rarely a goal in itself, but should normally be linked to some form of goals regarding return on capital.

- The sixth indent, which states that the company board may decide unilaterally that an agreed severance package should not be honoured "…if the termination is for poor performance" appears odd in the Swedish context. Here, the justification for such agreements, at least in part, is to strengthen the CEO's integrity in working for the best interests of the company by offering financial security should the CEO come into conflict with the board. This may be undermined by a stipulation that severance packages will not be paid out if the CEO resigns because the board feels that he or she has not done a good enough job. Giving boards the unilateral right to deny a CEO an agreed severance package on such grounds may not only be legally dubious, but also inappropriate for the company.

- The Board is also doubtful about the final indent, which contains a general clause giving the company board the right to change agreed terms and conditions if these are found to result in unfair or exaggerated remunerations. Giving one party to an agreement the right to change the terms and conditions is dubious in principle. Furthermore, the motivation to prevent exaggerated levels of pay may be counteracted if boards know they can always adjust any agreements that retrospectively appear too generous. Examples of such agreements have occurred in Sweden in recent years, but to make this a general principle would, in the opinion of the Board, not be appropriate.

Stockholm, 14 April 2009

THE SWEDISH CORPORATE GOVERNANCE BOARD

Per Lekvall
Board Secretary