1st International conference "Corporate Governance – new experiences: Implementation in South Eastern Europe

Board remuneration and independence – where is Croatia?

University of Zagreb
Faculty of Economics & Business

Prof. Hana Horak, Ph.D.

Kosjenka Dumančić, Ph.D.

Faculty of Economics and Business

University of Zagreb

- Good CG practice: non-executive and supervisory directors should:
  - have required diversity of knowledge, judgment and experience to complete their tasks properly
  - have particular competences that are relevant to their services in the board
  - properly understand their role in management and supervision in the company
  - devote to their duties necessary time and attention (undertake to the limit the number of their other professional commitments to such extent that the proper performance of their duties is assured)

  EC Recommendation 2005/162/EC

Regulatory framework

- Companies Act (107/2009)
- Commission recommendation fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC)
- Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC)
- European Recommendation on remuneration of directors of companies listed on European Exchange (C(2009)3177) amending Directive 2004/913/EC and Directive 2005/162/EC
- CG Code (2010)

Croatian association of the supervisory and management board (HUCNO) Recommendations

HUCNO (Croatian association of the supervisory and management board members) 2008

- Recommendation on remuneration
- Recommendation on independence

(in accordance with EC Recommendations)

Two main questions:

- independence
- remuneration

Independence

- Independence – non existence of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement (EC Recommendation 2005)

- special attention! - on possibility of damage as a result of close relationship with the companies competitors, dealing with situations involving conflict of interest

Profile of the independent non-executive director/supervisory board member

EC Recommendation (2005) on the role of non-executive or supervisory directors – implementation in Croatia:

- number of criteria for assessment are adopted at national level:

member of the supervisory board/non-executive director is independent:

- has not been a member of management board of the company or any of its dependent or related companies for at least five years (CG Code, art. 4.2.2. para2)

- has not been an employee of the company, or of any of its dependent or related companies for at last three years (CG Code, art 4.2.2. para 3)

- does not and did not receive any other significant payment from the company except for the remuneration for supervisory board activities, excluding any dividends (which especially relies to bonuses and other types of remuneration which depend on the company s business results, such as stock options but which does not relate to earnings resulting from the pension scheme for the previous employment in the company) (CG Code, art. 4.2.2. para 4)

- is not and has not been, for the period of at least one year, in any significant business relation with the company or its associated companies, directly or indirectly as a partner, shareholder, member of the management or the supervisory board or a senior manager of an organization which has significant business relations with the company, including significant indirect or direct suppliers/or buyers of goods and/or services of the company (including financial, legal, advisory and consulting services) and organizations receiving significant income from the company or its associated companies, (CG code, art. 4.2.2. para 5)

- is not, and has not been in the last three years, a partner or an employee of an audit company which provides or provided audit services to the company or its associated companies, (CG Code, art. 4.2.2. para 6)
- is not a member of the management of another company in which a member of the company s management is a member of the supervisory board, and does not have any significant relations with members of the company s management through participation in other organizations, bodies or companies (CG Code, 4.2.2., para 7)
- has not been a member of the supervisory board for more than 12 years (CG Code, 4.2.2., para 8)
- is not a spouse or a close relative or in-law of any of the members of the management or natural persons holding the abovementioned positions (CG Code, 4.2.2., para 9)

Recommendations (2005)

- more suitable for one tier CG system

- two tier CG system - automatically higher level of independence due to the institutional separation
- in Croatian, Slovenian and German company law independence is defined by law: non possibility to be the member of the supervisory and management board of the same company in the same time

Separation of the role of supervisory board member and management

Companies Act, Art. 261

Member of the supervisory board cannot be in the same time member of the management board, representative of the member of the board or agent of the company.

EXCEPTION:

The supervisory board may appoint some of its members as deputies of the lacking management board members or of the members incapable of performing their duties.

Such appointment may be made for the previously specified period of time and certainly not over one year.

Cooling-Off period

- Do we need to implement **Cooling-Off period ?**

- members of the management board cannot become members of the supervisory board of the listed companies in the two years period after their mandate as a members of the board (example: Germany)

Fostering the position of the members of the supervisory boards and non-executive directors

Liability for a good Corporate governance

Companies Act, art. 272. p

Corporate governance statement **/comply or explain principle/**

Supervisory board or board of directors of a company whose shares are admitted to trading on a regulated market shall ensure that the management i.e. executive directors of the company report in a separate section of the annual report on the condition of the company at least:

… information on the CG code to which the company is subject and/or the CG code which the company voluntarily decided to apply (para.1, a)

… whether the company deviates from the CG code and explanation for deviations area (para.1, b)

… description of the essential features of internal audit of the company and risk management in relation to financial reporting (para.1, c)

… information about the composition and operations of management board i.e. executive directors and supervisory board i.e. board of directors and their committees (para. 1, e)

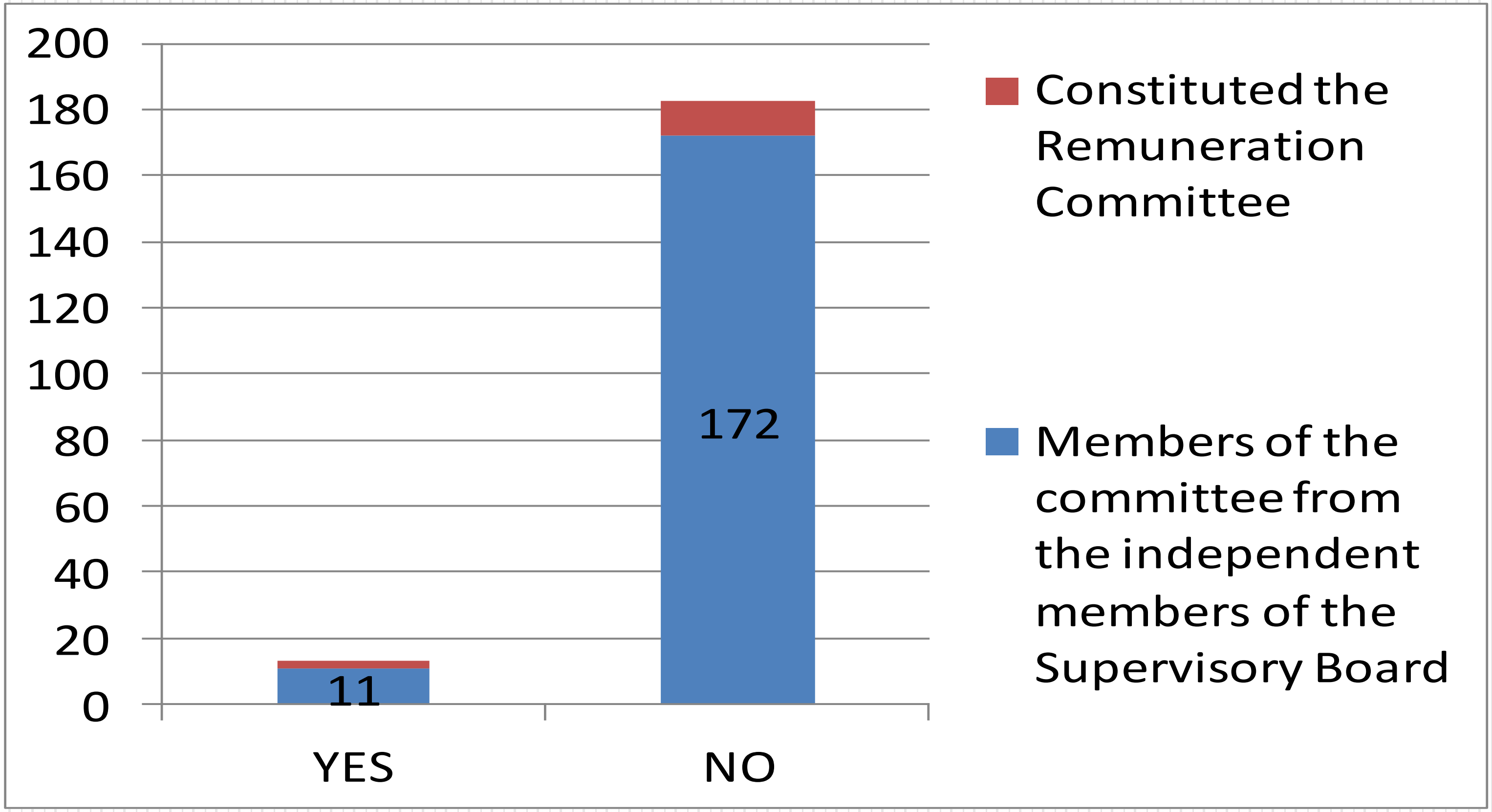
Boards committees

Important in the areas where the potential conflict of interest is particulary high: remuneration, nomination of directors, audit.

Companies Act, Art.264., para. 3
Supervisory board and management board can appoint committees.

The remuneration committee should have at least three members. If there is more the number should be odd. The majority of the committee members shall be selected from the group of independent members of the supervisory board (CG Code, art. 4.12.2)

Remuneration Committee



Remuneration

Management board/executive directors differences in relation **with**

supervisory board/non-executive directors in management board

- performing their role as a secondary job
- non existence of competition ban
- remuneration is lower than remuneration for the management board members

Executive compensation, remuneration

Motivation instrument

- better management
- contribution to the share value
- connecting the interests of management board members and executive directors and shareholders

Importance of Recommendations

1. Transparency of the in formations for the shareholders /internal mechanism of CG/:
   - remuneration structure
   - amount of remuneration
2. appointment of committee for remuneration that helps supervisory bodies to define appropriate remuneration
3. Transparency for all the stakeholders on the capital market

Executive remuneration

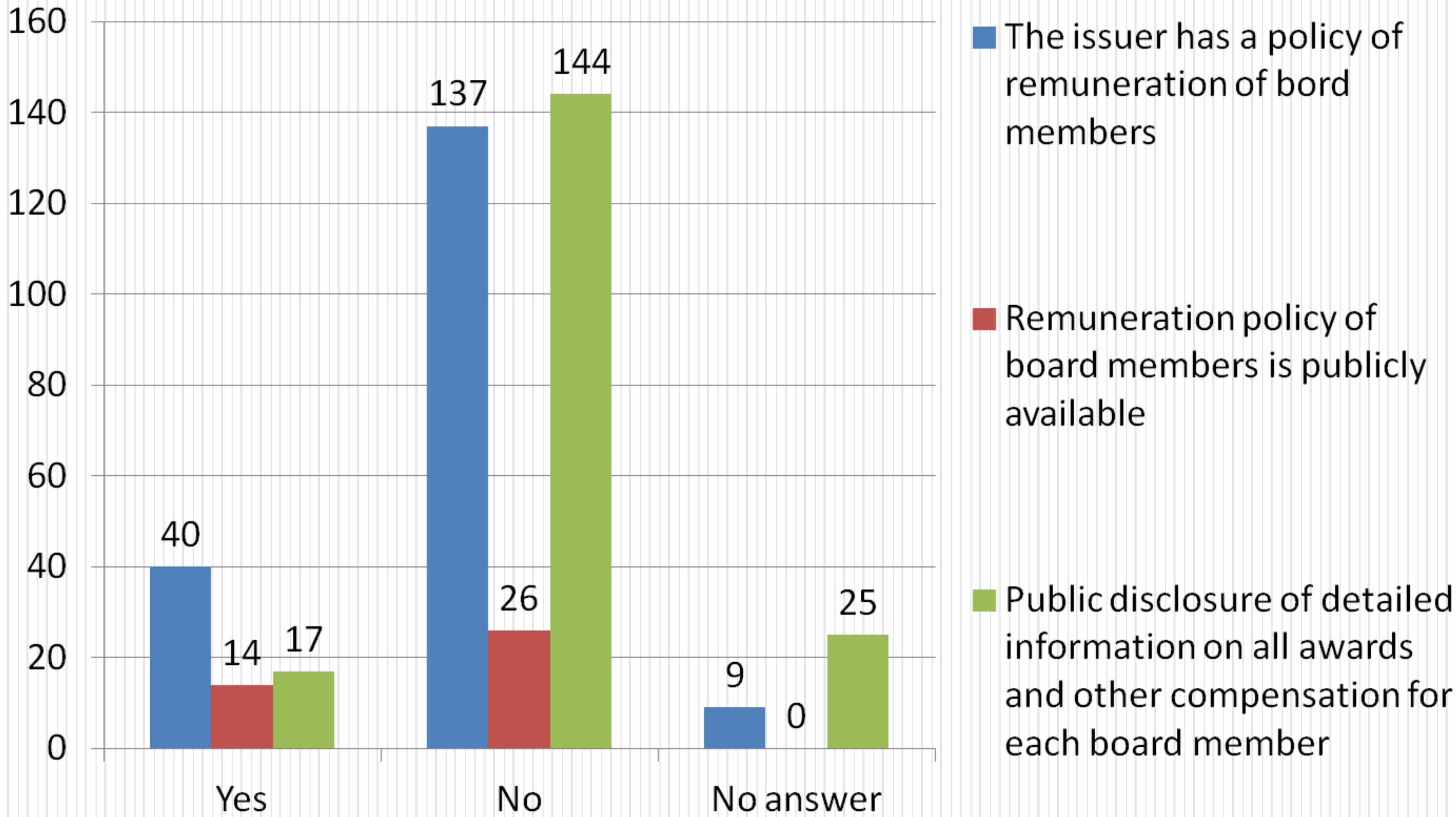
- Companies Act, art 247 – principles for management board remuneration

In the calculation of total receipts of a particular management board member (salary, share in the company profits, reimbursement of expenses, payment of insurance premium, commission and all other receipts) the supervisory board shall carefully observe that total receipt amounts are in proportion with the work executed by that management board member and with the position of the company.

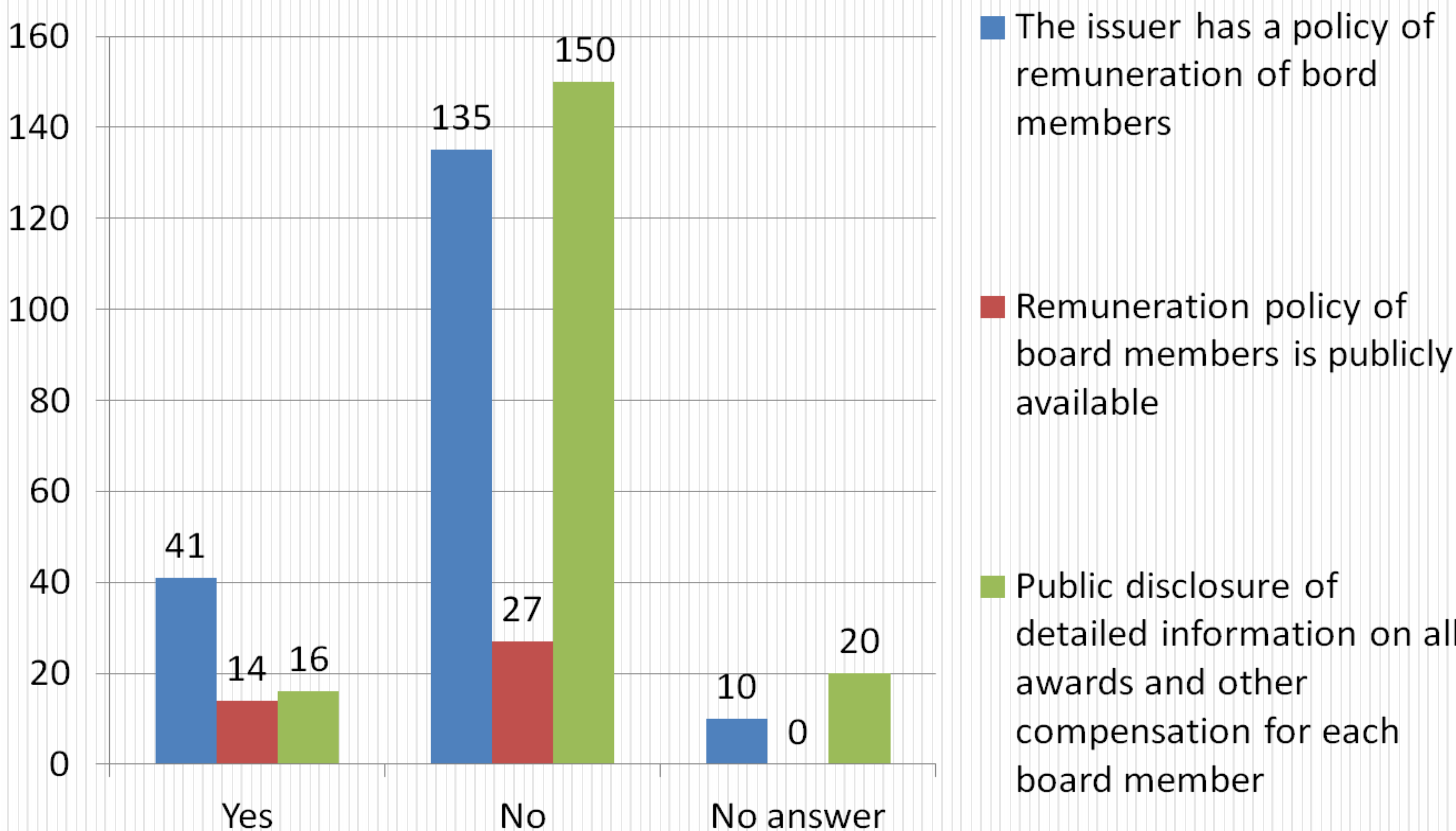
According to the data issued in HANFA Report (Croatian financial services supervisory agency) in 2011.

*data from HANFA Report, p. 48 (see next slides)

Remuneration policy for excecutive board members in 2009.

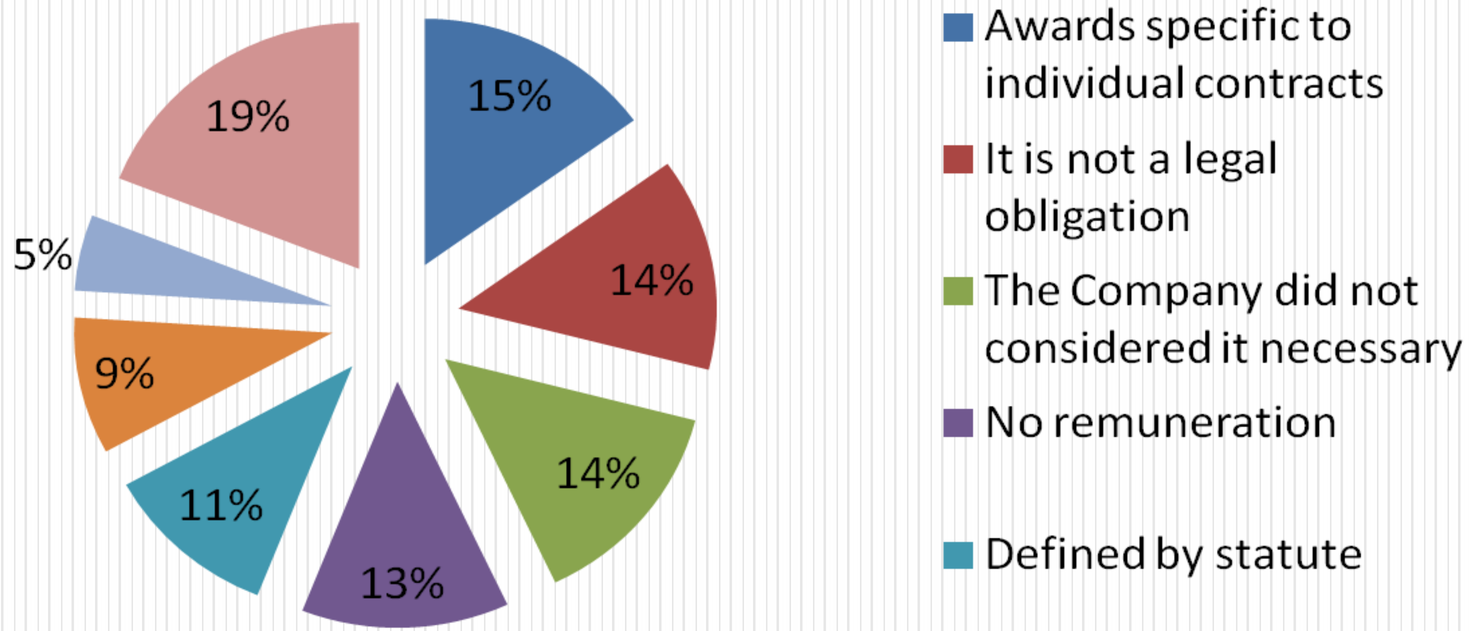


Remuneration policy for executive board members in 2010.



year		yes	no	No answer	total
2009	Issuer have remuneration policy statement	40	137	9	186
	Remuneration policy statement published	14	26	0	40
	Detaliled dana on all earnings and remuneration received by each member of the menagement/executive director published	17	144	25	186
2010	Issuer have remuneration policy statement	41	135	10	186
	Remuneration policy statement published	14	27	0	41
	Detailed data on all earnings and remuneration received by each member of the management/executive director published	16	150	20	186

Reasons why the company did not issue a statement of remuneration policy management and supervisory board as part of the annual report



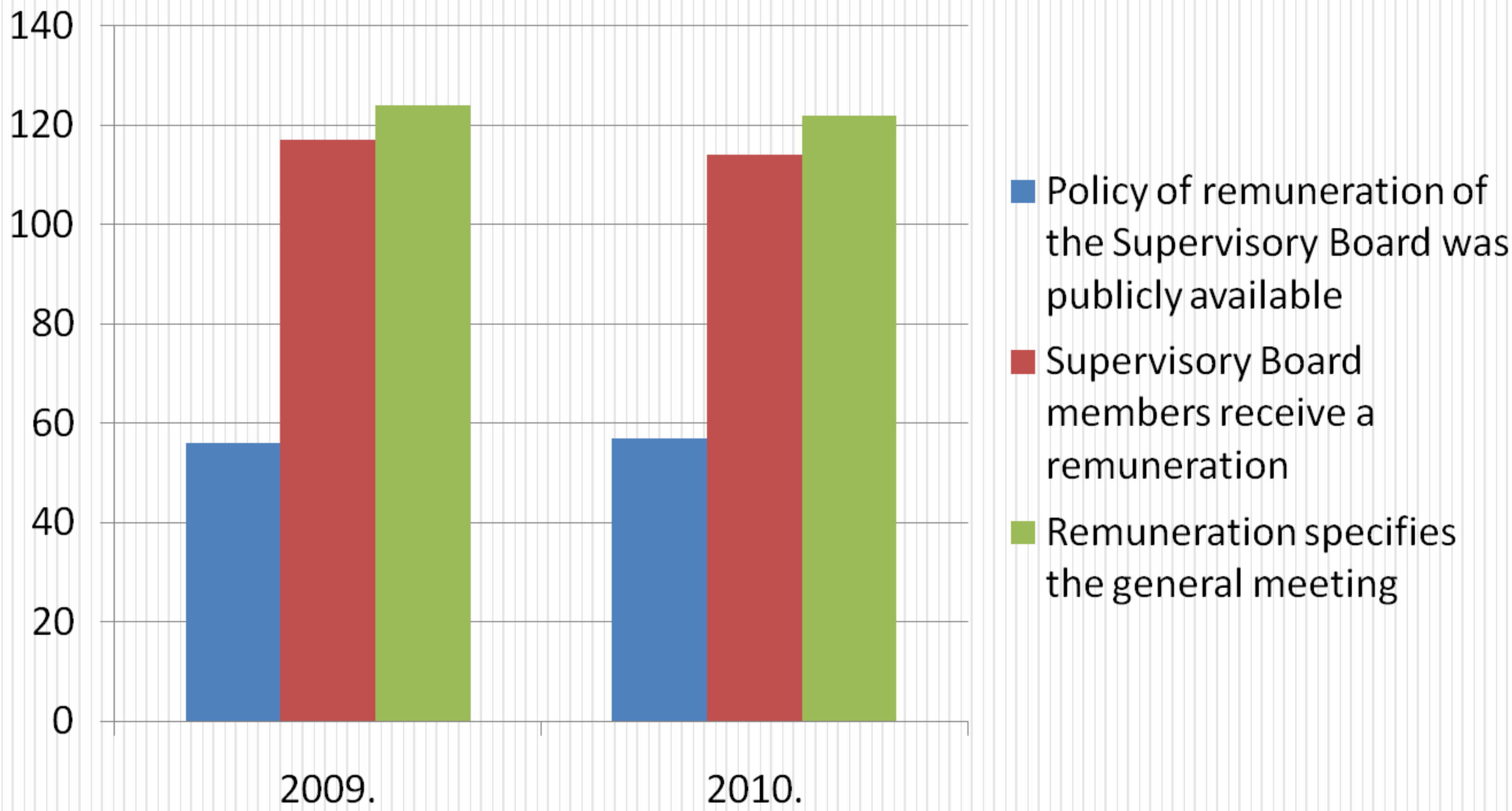
Remuneration for the supervisory board members and non executive directors

Companies Act, Article 269.

- For their work the supervisory board members may receive awards.

The award of supervisory board member may be determined proportionately with his share in the company profits. The award may also be determined by the Statue or by the general assembly of the company. In any case, the award shall be adequate to operations performed by the relevant board member and to the position of the company.

Supervisory board Remuneration Policy



CG Code in state owned companies

- CG Code for state owned companies 2010

Independence

Art 3.2.3. definition of independent supervisory board member:

- Is not related to the company, with possible exception in the case of possession of minor number of shares
- Is not a major shareholder, representative of major group of shareholders, a spouse or a relative or in –law to the second degree of any person from above mentioned group and is in any relation with the companies related to the majority shareholder
- Is not and has not be employee of the company or its depended or related company in last three years

- Is not direct/indirect supplier/buyer of goods and/or services of the company
- Is not employee of the company that is in business relation and supplies/buys goods/services from/to company
- Is not a relative or spouse to any member of management board
- Doesn't receive compensation from the company except remuneration for its position in supervisory board

- The same condition as the CG Code

Remuneration

- Art 3.2.6.

The remuneration shall consist of:

- Fixed part – does not depend on operating results, unless operating results of the company show that the payment of fixed remuneration would be undeserved and in great disproportion with operating results
- Variable part – depends on operating results during a certain past or future period

- Same as in CG code

- The average compensation for members of supervisory board in state owned companies is fixed and it is 2000 kuna (cca 280 EUR) net per month
- Supervisory/management board committees: obligatory (Art. 4.5)

Conclusion

Question:

Do SOE need a different approach in comparison with other companies ?

Should compensation for supervisory board members/non-executives in SOE differ from the compensations in other companies?

If YES – why and how?

Implementation of the OECD recommendations/EU regulatory framework