

BLACKROCK®

Our Approach to Executive Remuneration in Europe, the Middle East and Africa

JANUARY 2017



Our Approach to Executive Remuneration in EMEA

We describe herein our beliefs and expectations related to executive remuneration¹ practices, our Say on Pay² analysis framework, and our typical approach to engagement and voting on Say on Pay. We provide our views on this issue in somewhat more detail than other issues covered in our various regional proxy voting guidelines because of the particular focus on executive remuneration matters following the adoption of Say on Pay regulations in a number of markets. We outline our general approach for the EMEA region, although we acknowledge that Say on Pay and relevant disclosures are not equally applicable to every jurisdiction.

The key purpose of remuneration is to reward, attract and retain competent directors, executives and other staff who are fundamental to the long-term sustainable growth of the company, with reward for executives contingent at least in part on controllable outcomes that add value. BlackRock believes that each company should structure their remuneration policies and practices in a manner that suits the needs of that particular company given the broader context and environment it operates in.

When assessing remuneration policies and practices of listed companies BlackRock is looking for a cogent explanation for the policies used and, in respect of executive remuneration in particular, a clear link to the company's stated strategy.

Remuneration Consultations

- We encourage companies to use these guidelines in developing their pay policies, as they will inform BlackRock's approach to engagement around pay. Clear consideration of these guidelines will help produce optimally productive engagements.
- We expect issuers' public disclosures to be the primary mechanism for companies to explain their executive remuneration practices. Where concerns are identified or where we seek to better understand a company's approach to executive remuneration, we may engage with companies, preferably independent members of the remuneration committee of the board.

Beliefs and Expectations Related to Executive Remuneration Practices

- We believe that remuneration committees are in the best position to make remuneration decisions and should maintain significant flexibility in administering remuneration programs, given their knowledge of the strategic plans for the company, the industry in which the company operates the appropriate performance measures for the company, and other issues internal and/or unique to the company.
- Companies should explicitly disclose how incentive plans reflect strategy and incorporate long-term shareholder value drivers; this discussion should include the commensurate metrics and timeframes by which shareholders should assess performance.
- BlackRock believes that remuneration plans should allow remuneration committees to have discretion to make adjustments as a result of unintended outcomes from plans. Where discretion has been used by the remuneration committee we expect disclosure relating to how and why the discretion was used and further, how the adjusted outcome is aligned with the interests of shareholders

¹ The term 'remuneration' is used as an equivalent to the words 'compensation' or 'pay'.

² The terminology can vary depending on markets but 'Say on Pay' is the generic expression referring to the ability of shareholders to vote on the remuneration of executives. The vote can be advisory or binding, as well as prospective or retrospective.

- BlackRock does not discourage remuneration structures that differ from market practice. However, where remuneration practices differ substantially from market practice, e.g. in the event of unconventional incentive plan design or extraordinary decisions made in the context of transformational corporate events or turnaround situations, we expect clear disclosure explaining how the decisions are in shareholders' best long-term economic interests.
- We expect remuneration committees to ensure that incentive plans do not incentivize excessive risk taking beyond the company's determined risk appetite and that rewards are reasonable in light of risk-adjusted returns to shareholders.
- We expect remuneration committees to consider and respond to the shareholder voting results of relevant proposals at previous years' annual meetings, and other feedback received from shareholders, as they evaluate remuneration plans. At the same time, remuneration committees should ultimately be focused on incentivizing long-term shareholder value creation and not necessarily on achieving a certain level of support on Say on Pay at any particular shareholder meeting.

Remuneration Consultants

- We believe boards should provide more transparency in their reporting on their use of remuneration consultants. Disclosures should cover the name of the consultant, fees paid, the nature of all services provided, and the chain of accountability, e.g. to the board or to management.
- Discourse on what the board saw as the merits of the particular advisor relative to in-house or in-board expertise would also be useful. Greater transparency will help demonstrate whether directors have the required competency and whether there are any conflicts of interest, e.g. providing advice to the board but being paid by management.

Say on Pay Analysis Framework

- We analyse the remuneration practices in the context of the company's stated strategy and identified value drivers and seek to understand the link between strategy, value drivers and incentive plan design.
- We review executive remuneration granted during the year in terms of total remuneration that may be earned at threshold, target and maximum performance. Such an approach provides an understanding of the remuneration committee's intended outcomes based on various performance scenarios and to judge the appropriateness and rigor of performance measures and hurdles.
- We make an assessment of the relevance of the company's stated peers and the potential impact the company's peer selection may have on pay decisions.
- We conduct our analysis over various time horizons, with an emphasis on a sustained period, generally 3-5 years; however we consider company-specific factors, including the timeframe the company uses for performance evaluation, the nature of the industry, and the typical business cycle, in order to identify an appropriate timeframe for evaluation.
- We review key changes to pay components from previous years and consider the remuneration committee's rationale for those changes.
- Where we see extraordinary pay items (including but not limited to actual or contractual severance payments, inducement grants, one-time bonus and/or retention awards) we expect to see a clear explanation to understand the remuneration committee's rationale and how such payments are aligned with long term shareholder interests.
- We may engage with companies, preferably independent members of the remuneration committee or of the board, where concerns are identified or where we seek to better understand a company's approach to executive remuneration.

- We consider BlackRock’s historical voting decisions (including whether a concern that led to a previous vote against management has been addressed, or whether we determined to support management at previous shareholder meetings with the expectation of future change), engagement activity, other corporate governance concerns at the company, and the views of our portfolio managers.
- We assess the board’s responsiveness to shareholder voting results of relevant proposals at previous years’ annual meetings, and other feedback received from shareholders.

Engagement and Voting on Say on Pay

- In many instances, we believe that direct discussion with companies, in particular with the members of the remuneration committee, can be an effective mechanism for building mutual understanding on executive remuneration issues and for communicating any concerns we may have on executive remuneration.
- In the event that we determine engagement has not or is not expected to lead to resolution of our concerns, we will consider voting against members of the remuneration committee, consistent with our preferred approach to hold members of the relevant key committee of the board accountable for governance concerns.
- We will vote against the election of remuneration committee members and/or Say on Pay proposals in certain instances, including but not limited to when:
 - We identify a misalignment over time between threshold, target pay and maximum remuneration outcomes and company performance as reflected in financial and operational performance and/or shareholder returns;
 - We determine that a company has not persuasively demonstrated the connection between strategy, long-term shareholder value creation and incentive plan design;
 - We determine that remuneration is excessive relative to peers without appropriate rationale or explanation, including the appropriateness of the company’s selected peers;
 - We observe an overreliance on discretion or extraordinary pay decisions to reward executives, without clearly demonstrating how these decisions are aligned with shareholders’ interests;
 - We determine that company disclosure is insufficient to undertake our pay analysis; and/or
 - We observe a lack of board responsiveness to significant investor concern on executive remuneration issues.
- We will systematically vote against a Say on Pay when:
 - There is no mention of the use of performance criteria for the vesting of long-term awards or it is explicitly stated there will not be any disclosure around the performance criteria, with the exception of restricted schemes (see below);
 - A long-term incentive plan allows for “retesting,” i.e. multiple opportunities to achieve the performance criteria; and/or
 - A board of directors decides to make retrospective/in-flight changes to performance criteria.

Executive Remuneration Guidelines

The following guidelines detail what we believe are the best practices regarding executive pay. These guidelines should serve as a possible framework for remuneration committees to consider but not as a set of binding voting rules. Our approach will remain a pragmatic one based on a case-by-case analysis. When we have concerns our first step will usually be to engage with members of the remuneration committee to share our views.

Fixed remuneration

- When setting fixed pay, we expect boards to start by determining the right cost for the specific position. This amount should be based on a calculated assessment of what needs to be paid to get the job done and should be aligned with the pay policy of the company for the rest of the workforce. The board should also consider the pay ratio between the CEO and the rest of the executive team, looking at both the fixed and the total remuneration.
- Benchmarking should be used only to establish a frame of reference for what competitors are paying, rather than as the starting point for negotiations.
- We expect companies to select peers that are broadly comparable to the company in question, based on objective criteria that are directly relevant to setting competitive remuneration; we evaluate peer group selection based on factors including, but not limited to, business size, relevance, complexity, risk profile, and/or geography.
- Benchmarking tools should be used in a transparent manner, i.e. we expect the results to be disclosed by the company, especially the peer group selected.
- In case of a significant pay increase year-on-year that is out of line with the rest of the workforce, BlackRock expects the company to provide a strong supporting rationale. Large increases should not be justified principally by benchmarking but should progress in pace with the evolution of the scope of the role and its complexity. If justified by additional complexity, we expect companies to provide a detailed explanation of how the role has substantially changed. We do not see the size of the capital of the company as an appropriate proxy for the complexity of the role or as appropriate justification for an increase in salary;
- We expect boards to consider the timing of any pay increase relative to the current performance of the company. Especially in the case of a merger or acquisition, boards should wait a number of years before increasing remuneration to ensure that the executives are delivering sustained performance.

Pensions and Benefits

- Pensions and benefits should not be used in the calculation of variable pay.
- We view pensions as being part of the benefits offered by a company and therefore we expect pension contributions for executives to be in line with the rest of the workforce. Contracts for new executives should reflect this alignment. Any downgrade of the workforce's pensions should also be applied to the executives.

Recruitment packages

- Any proposed package should be primarily determined in relationship to the nature and the specifics of the role for a company of this size and complexity. Any large disparity with the remuneration of the former executive should be explained in detail by the company.

- Buyout awards, if necessary, should only be made in shares or similar at-risk vehicles and should be aligned with the recruiting company's strategy and metrics; vesting can be aligned with the executive's prior employment cycle.

Severance, Retirement and Change in Control

- Severance payments should not be made to executives whose contracts have been terminated as a result of poor performance, who have chosen to leave the company, or who are retiring.
- Severance payments should be limited to two years of fixed remuneration (including bonus in markets where this is the expected practice).
- Severance payments should only be paid in case of forced departure of a good leaver. The non-renewal of a mandate should not be construed as a forced departure.
- In case of good leavers, unvested awards should vest pro-rated for time and performance and lapse in full in case of bad leavers. In case of a voluntary change of employment, the executive's unvested awards should lapse in full as well.
- A good leaver is one which leaves the company due to: retirement, personal circumstances preventing the executive from fulfilling the role, change in control/strategy when the post becomes redundant or the incumbent executive's skills are not aligned. A bad leaver is one which leaves the company due to forced or agreed departure due to inadequate performance or behaviour of that individual.

One-off Awards

- Any one-off award should be based on very exceptional circumstances that would need to be detailed by the company.
- Without adequate explanation, we will usually oppose one-off awards linked to transactions as these awards could create an incentive for executives to undertake unnecessary (and at times value-destroying) acquisitions. Moreover, any merger or acquisition entails significant risks that investors will have to face for a number of years after the transaction.
- We will also usually vote against retention awards as, in our experience, they are not an effective tool to retain employees.

Variable Pay

- Given the uniqueness of each listed company, and the numerous industries in which companies operate, we do not believe there is a "one size fits all" approach to the structure of executive remuneration. Boards of directors should structure executive remuneration plans that best suit their company taking into account such factors as the company's pay policy, strategy and business cycle. We do not set forth a preference between cash, restricted stock, performance based equity awards, and stock options, amongst other remuneration vehicles. We acknowledge that each may have an appropriate role in recruiting and retaining executives, in incentivizing behaviour, in fostering the right culture and performance and in aligning shareholders' and executives' interests. Remuneration committees should clearly disclose the rationale behind their selection of pay vehicles and how these fit with intended incentives. We also observe that different types of awards exhibit varying risk profiles, and the risks associated with pay plan design should be in line with the company's stated strategy and risk appetite.
- Boards should provide a picture of what the pay package could look like depending on different performance scenarios and on different time horizons for investors to be able to assess adequately the pay-related proposals.

- We expect companies to disclose the value of the remuneration to be granted in a particular year based on threshold, target and maximum performance (values should be measured by face value at grant date).
- We support incentive plans that foster the sustainable achievement of results. Although we believe that companies should identify those performance measures most directly tied to shareholder value creation, we also believe that emphasis should be on those factors within management’s control to create economic value over the long-term, which should ultimately lead to sustained shareholder returns over the long-term.
- We are wary of companies using only “output” metrics such as earnings per share (“EPS”) or total shareholder return (“TSR”). Our preference is for “input” metrics as these are within management’s control. TSR, if used, should be assessed on a relative basis or companies should provide a cogent explanation for why this is not adequate. Companies using EPS should exclude the potential short term effects of share buybacks and acquisitions. We also encourage companies to use metrics related to the creation of value of the company (e.g. the economic profit or a comparison of return on invested capital (“ROIC”) and the cost of capital).
- Short-term and long-term incentive plans should be based on different sets of performance measures.
- The performance measures should be majority financial and at least 60% of them should be based on quantitative criteria. Variable pay should be based on multiple criteria. We expect full disclosure of the performance measures selected and the rationale for the selection of such performance measures. If the board decides to use ESG-type criteria, these criteria should be linked to material issues and they must be quantifiable, transparent and auditable. Where financial measures constitute less than 60% of performance measures a cogent explanation should be provided.
- Retrospective disclosure should be provided on the performance achieved, broken down by measure, for quantitative and qualitative metrics alike. For markets where it is the expected practice, the performance metrics and targets should be disclosed prospectively.
- Regarding long-term incentive plans, we expect the performance duration to be in line with the business cycle of the company. When the vesting period is two years or less, due to a short business cycle, an explanation should be provided and there should be a sufficient subsequent holding period beyond the vesting of awards to ensure the long-term focus by management.
- Currency exposure: we do not believe one group of stakeholders should be sheltered from the impact of currency fluctuations. We expect companies to mitigate currency risks as any other risk.
 - Restricted Schemes
- Some companies might consider that a restricted scheme fits better with their remuneration philosophy. We expect these companies to provide detailed rationale to justify this decision. Moreover, the introduction of a restricted scheme should not result in a more complex pay package.
- Given the certainty of these schemes, we expect the value awards to be reduced by at least 50% in comparison to the variable pay previously available. Any subsequent increase should be avoided or justified by specific circumstances.
- The vesting/holding period(s) should have a longer timeframe, preferably a minimum of five years.
- To avoid pay for failure, we believe an underpin should be applied to these schemes, i.e. the awards should not vest if a minimum level of performance has not been achieved.
- For the companies granting restricted shares, we encourage the board to increase the shareholding requirement to at least four times’ fixed pay, that should be maintained for at least two years post departure to ensure longer term alignment with shareholders.

- Matching plans
- Boards should refrain from using matching plans if they are already using other types of long-term incentive plans.
- Matching should be limited to a one for one ratio and should be linked to additional performance criteria.

Shareholding Requirement

- For all companies, we encourage boards to set executive shareholding requirement at least at the level of maximum annual aggregate variable pay.