



**Preparing for the Shareholder Rights
Directive in Sweden**

September 2018

Introduction

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The European Commission proposed amendments to the Shareholder Rights Directive in April 2014. The Directive has been agreed by the European Parliament, Council and Commission negotiators in December 2016 and was adopted in May 2017. Member States have until June 2019 to implement the Directive. Justitiedepartementet issued a draft proposal for implementation into Swedish law in May 2018, providing the initial clarity required for companies to begin planning for the introduction of the SRD.

We summarise here the key remuneration related issues, the gaps to current practice in Sweden, and what companies can do now to prepare for the January 2019 implementation.

Key points

Justitiedepartementet proposal for implementation into Swedish law highlights:

Remuneration Policy

- To be subject to an annual binding vote at the General Meeting (GM).
- Excludes board member remuneration and issue of shares, warrants or convertible instruments (these remain subject to existing GM resolutions).
- Deviation from the policy only permitted if the GM has decided (within the policy) on the provisions on deviation.

Remuneration report

- To be presented at the GM (non-binding vote) annually.
- No exemption for small and medium sized companies.
- Failure to pass the remuneration report vote requires that in the following years' remuneration report note is made of why it failed and what actions the company took to rectify it.
- To be published separately to the annual report, and available online
- The current legal definition of 'Senior Management' will remain, with individual pay disclosure for the CEO, deputy CEO (if any) required in line with current practice.

Key dates

- Implementation document issued for consultation until 31 August 2018.
- SRD to be effective from 1 July 2019, with first policy votes in the 2020 GMs.
- First remuneration report votes to be table at 2021 GMs.
- Guidance from the Commission expected Q4 2018 regarding details of pay disclosure in the remuneration report.
- A final Swedish government bill is expected to be drafted in March 2019.

Main implications for Swedish listed companies

- The SRD will restrict Swedish listed companies to pay management only within the terms of a tightly defined policy and to report in detail how that policy was applied. The flexibility that exists under current practice will end.
- Greater transparency in reporting will be required, a considerable change from current requirements. This will raise the profile of remuneration in Sweden leading to greater investor, media and proxy adviser scrutiny.
- The SRD therefore represents a challenge for companies to improve communication and transparency, taking a cautious view on voluntary disclosures and aligning policies share plan rules, service contracts, and board meeting minutes.
- Plan early and take a view as to how 2018 remuneration disclosures, under current reporting requirements, will evolve ahead of the SRD implementation.
 - Be clear on the gaps between the existing management remuneration policy and the SRD requirements.
 - Be aware of key changes such as restrictions on discretion and transparency on variable pay KPIs.
 - Draft revised disclosures well ahead of the deadline so decision making can evolve.
 - Engage with shareholders and proxy advisors.

Current remuneration voting and disclosure practice in Sweden

The requirement to seek shareholder approval for remuneration practices is limited to companies listed on an EU-defined regulated market, i.e. the Stockholm Stock Exchange Nordic List and the Nordic Growth Markets Equity List. These say-on-pay proposals however are brief documents. A typical resolution will outline the different forms of remuneration, incentive caps and a broad indication of performance criteria. These proposals tend to be voted through with minimal shareholder opposition. Further, most of these proposals include a clause allowing the Board to deviate from the guidelines if warranted by circumstances. In addition, equity-backed long-term incentive plans are presented as separate items at Swedish meetings, although they are usually mentioned in the executive remuneration guidelines.

In terms of disclosure, the annual report breaks down the amounts paid to executives for the year in question across different remuneration categories, although remuneration figures are only presented individually for the CEO.

Overall the current remuneration disclosure regime in Sweden is light-touch characterised by broad remuneration policies attracting limited shareholder activism (for the most part). Given factors such as the influence of a select number of large shareholders, overall remuneration levels remaining modest relative to other European countries, as well as the extra shareholder protection in equity plans where approval in some cases requires a 90% voting majority, the Swedish system has worked tolerably well.

The SRD, however, will disrupt this model.

What are the key challenges for Swedish companies? What can be done now to prepare?

A key focus of the Directive is the separation of a remuneration policy and an annual remuneration report. The policy effectively provides a 'licence' to pay management and the Board, while the remuneration report provides shareholders with guidance on how the policy was applied in the last financial year. The level of detail required under the SRD goes well beyond existing practice for most companies. We outline the detail below and what companies can do ahead of the 2020 GM season.

SRD remuneration policy requirements

| SRD Requirement | What it means | Potential action steps |
|--|--|---|
| <p>Remuneration, long-term interests and sustainability This is the central ethos of the SRD.</p> <p>“The remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company and should not be linked entirely or mainly to short-term objectives. Directors’ performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors.”</p> | <p>The theme of sustainability is a central concept of the SRD. However, Swedish remuneration policies typically do not (currently) focus on the link to strategy and sustainability. Swedish law does, however, require a separate sustainability report to be published.</p> <p>While under Swedish law, profit rather than sustainability is recognised as the objective of a firm (i.e. a shareholder versus stakeholder model), companies will be required to address the link between remuneration, strategy and sustainability. This may involve a more direct link between metrics outlined in the sustainability report and remuneration.</p> | <p>The quality of disclosure will vary across companies, and will develop over time.</p> <p>Best practice is to avoid a box-ticking approach. A review of the following is therefore recommended:</p> <ul style="list-style-type: none"> • Review of strategic plans against existing KPIs and how these cascade down the organisation. • Assess how sustainability is addressed via existing KPIs. • Analyse payout volatility under current metrics, including those under existing short and long-term incentives. • Assess competitor, Swedish and regional best practices on KPIs. • Ensure alignment with key shareholder views. • Determine a format of policy disclosure, including tables and or graphics. |

| SRD Requirement | What it means | Potential action steps |
|--|---|--|
| <p>Variable pay</p> <p>The SRD's requirements on variable pay are aimed at enhancing clarity of the rationale for the choice of metrics in incentive plans, and how they are assessed.</p> <p>"Indication of financial and non-financial performance criteria, including, where appropriate, criteria relating to corporate social responsibility."</p> <p>"Explanation of how each contributes to the company's strategy and long term performance."</p> <p>"Methods to be applied to determine to which extent the performance criteria have been fulfilled."</p> | <p>Swedish practice is to generally provide no or minimal disclosure of variable pay measures and targets. A select number of companies provide more detail, including ex ante disclosure of measures and targets (although typically in the annual report, rather than the policy/guidelines put to shareholders at each GM).</p> <p>This requirement under the SRD will therefore be a significant issue for most companies to address.</p> | <p>As we have seen in other Nordic markets, practice will evolve with some companies identified as representing best practice through detailed ex ante measure and target disclosure while others are singled out for being less transparent.</p> <p>We therefore suggest:</p> <ul style="list-style-type: none"> • Assess Board appetite for level of detail of disclosure of variable pay metrics. • Review different disclosure approaches ranging from minimalist to full ex ante disclosure. • Determine strategy for evolving disclosures. This may include approaches that provide limited quantitative disclosure of targets. • Assess competitive practice and 'lessons learnt' in other regions where disclosure requirements are more prescriptive. |
| <p>Pay and employment conditions of employees</p> <p>The SRD requires detail on broader pay conditions although no detailed guidance is provided.</p> | <p>This is a requirement in other countries' policy disclosures but is rarely seen in Swedish remuneration policies. Sweden does, however, require employee representation on Boards. As such, there is scope for including any decisions taken/frameworks discussed into revised remuneration disclosures.</p> | <ul style="list-style-type: none"> • Clarify and articulate the overall principles that are applied to broader employee pay. • Specify any variations to the principles governing executive remuneration. • Outline any all-employee incentive plans in operation or incentive components that apply to all employees. |
| <p>Derogation (discretion)</p> <p>The discretion to deviate from the policy will be more restrictive.</p> <p>"...allow companies to apply such temporary derogation to the applicable remuneration policy if they specify ... how it would be applied in certain exceptional circumstances."</p> | <p>This is a key change for Swedish companies.</p> <p>There is usually a wide degree of freedom for companies to implement 'special arrangements' under their remuneration policies.</p> <p>Under the SRD, greater clarity on the time limitations, and what elements of pay may qualify for a temporary derogation is required.</p> <p>Justitiedepartementets draft framework has also clarified that deviation from the policy will only be permitted if the GM has decided (within the policy) on the provisions on deviation.</p> | <p>Review the existing intention and policy wording with respect to exceptional/ temporary remuneration practices.</p> <p>Clarify the following and be prepared to disclose:</p> <ul style="list-style-type: none"> • Under what circumstances will exceptional pay arrangements apply. • The time limit for such exceptions. • Quantum or caps applying. |

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|---|---|--|
| <p>Recovery</p> <p>The policy must specify details on the “possibility to reclaim variable remuneration.”</p> | <p>Malus or clawback provisions are not typically included in Swedish remuneration policies, yet are common in other countries. Clawback refers to the recovery of amounts relating to payments/ awards that have been settled while malus refers to the reduction/cancellation of payments/awards that have not yet been paid.</p> <p>The SRD as drafted does not provide any further detail, nor does it specify between malus and clawback. Therefore, it will be a matter of judgement for companies.</p> | <p>Practice will evolve in respect of clawback conditions, as seen in other countries, such as Denmark where clawback provisions are increasingly seen.</p> <p>It is sensible now to establish an approach to malus and clawback including consideration of:</p> <ul style="list-style-type: none"> • The circumstances in which malus / clawback would apply. • The period over which clawback may apply retrospectively. • The alignment of malus and clawback provisions with executives’ contracts. |
| <p>Vesting deferral and holding periods</p> <p>The policy is required to outline these in detail.</p> | <p>Vesting periods are already outlined in Swedish voting resolutions. However, post vesting retention of shares (holding periods) are not common.</p> | <p>Holding periods are not required by the SRD.</p> <p>Any consideration of holding periods should be taken in light of the overall remuneration approach.</p> |
| <p>Contracts and pensions</p> <p>The policy must indicate the duration of contracts, notice periods, and the main characteristics of supplementary pension or early retirement schemes. Also termination terms and payments linked to termination must be disclosed.</p> | <p>This requirement is largely satisfied through existing disclosures. However, a number of companies will be required to present more detail than currently provided on termination terms.</p> | <p>Review existing disclosures against the SRD requirements, focusing on the policy reporting ahead of the 2020 GM.</p> <p>Check alignment of share plan rules with contracts in respect of termination payments.</p> |

Remuneration report

As noted, the concept of a remuneration report, as viewed by the SRD does not currently exist in Swedish law or typical practice. The table below summarises the key requirements for the remuneration report as per the SRD's current drafting.

Annual remuneration report – Subject to an advisory vote

| <i>Each element including all benefits in whatever form awarded or due and total – Illustrative table</i> | | | | | | | Total remuneration |
|--|----------|----------|---------------------|-------|----------------------|--|--|
| Fixed pay | | | Pay for performance | | | | |
| Salary | Benefits | Pensions | Bonus | Bonus | Long Term Incentives | | |
| CEO | | | | | | | |
| Deputy CEO | | | | | | | |
| <p>For each director: Total remuneration split out by component Relative proportion of fixed and variable pay How total remuneration complies with the Policy <i>How performance criteria were applied (no prescribed requirement: performance conditions, weighting, actual targets and level of achievement)</i></p> | | | | | | | <p>Details of the approach to be taken for each element of remuneration is not defined in the SRD as yet (this includes benefits valuation, whether awards are reported on a fair value or realised pay basis).</p> <p>Method for comparing director's pay to company performance and employee remuneration not defined</p> <p>The Commission will publish guidelines for standardised presentation in 2018.</p> |
| <p>Payments to former directors</p> <p>Loss of office payment Not explicitly addressed in the directive but good practice would be to include treatment of outstanding incentive awards and any discretion exercised.</p> | | | | | | | <p>Discretion Explanation of any use of discretion to derogate from the policy during the year</p> <p>Directors' pay in relation to company performance and employees' remuneration <i>(criteria, method and format not defined)</i> Annual change in each director's total remuneration Annual change in performance of the company Annual change in the average remuneration for other employees (on a full time equivalent basis) Reported over the last 5 years.</p> |
| <p>Recovery and withholding provisions (clawback) Use of these provisions during the year.</p> | | | | | | | <p>Statement regarding shareholders' voting Explain how the vote at the previous GM was taken into account.</p> |
| <p>Share awards Number of shares and options granted including main conditions, exercise price and date of any change.</p> | | | | | | | <p>Remuneration for the next financial year <i>Not addressed in the directive but good practice to include information on approach for the following year.</i></p> |

Given the 1 July 2019 implementation date in Sweden, remuneration reports will not be required to be disclosed until 2021 GMs in respect of the 2020 financial year. This gives companies more time to consider the nature and form of their remuneration report content (less time is available for remuneration policy reporting, ie 2020 GMs).

The Commission is tasked with developing guidelines on a standard form of executive pay reporting which it is intended would apply across all member states. This work is likely to continue through the autumn of 2018.

There are several key issues that are yet to be resolved for the remuneration report content to be consistent across member states. Key examples include:

- While it appears there is a strong probability that the SRD will require a single-figure table similar to that reported in UK companies' annual reports, the definition of the elements of pay to be included remains undetermined.
- The reporting of share based awards will be a key issue. Practice varies in Europe with some countries reporting on a realised pay basis and others adopting an expected value/accounting cost approach. This will be a pain point for those companies that need to move from one approach to the other, which is necessary for consistency across member states.
- Executive shareholdings is an emerging trend in countries (on top of those countries such as the UK that have long reported this) and may also be included in the SRD. As this is not common in Sweden (but growing in prevalence in other Nordic countries) the inclusion of this in the SRD and subsequent remuneration reports may impact market practice and prevalence.
- Provisions for recovery will need to be disclosed, with companies likely having to specify the nature of events that might trigger malus/clawback, the pay elements from which adjustments could be made, and the time limit on its application.
- The comparisons in executive pay to company and employee performance will be another pain point for Swedish companies. TSR is commonly cited as the appropriate measure however not all stakeholders take this view. It is likely that the SRD will not specify a measure and allow companies choice in selecting the measure right for them. This raises the issue of the need to be consistent with the measure adopted.

Getting ahead of the regulations

It is important not to underestimate the impact of the SRD for Swedish companies. Our experience from other regions such as the UK which introduced prescriptive disclosure rules in 2014 (currently the strictest in Europe and which the SRD has some similarities to) is that the new depth of information provides a more detailed platform to scrutinise (and criticise) executive pay. In the Nordic region we are in any case seeing evidence of enhanced disclosure practices. For example, Denmark has recently seen more detailed remuneration disclosures being put before shareholders and the introduction of a new governance code (including a recommendation for publishing a remuneration report), as well as incentive practices more typical of broader European practice such as shareholding guidelines holding periods, performance share plans, and even ex poste caps.

Overall, the SRD will build on the growing appetite among stakeholders for more transparency and will play well for investors, proxy advisors and the media. The SRD will:

- Through the increased consistency of reporting, make it easier to compare and judge pay levels and practices, leading to a greater appetite among external stakeholders to offer their views on remuneration practices.
- Enable business and broader public support for implementing changes (for example specific performance measures, holding periods, limitations on discretion).

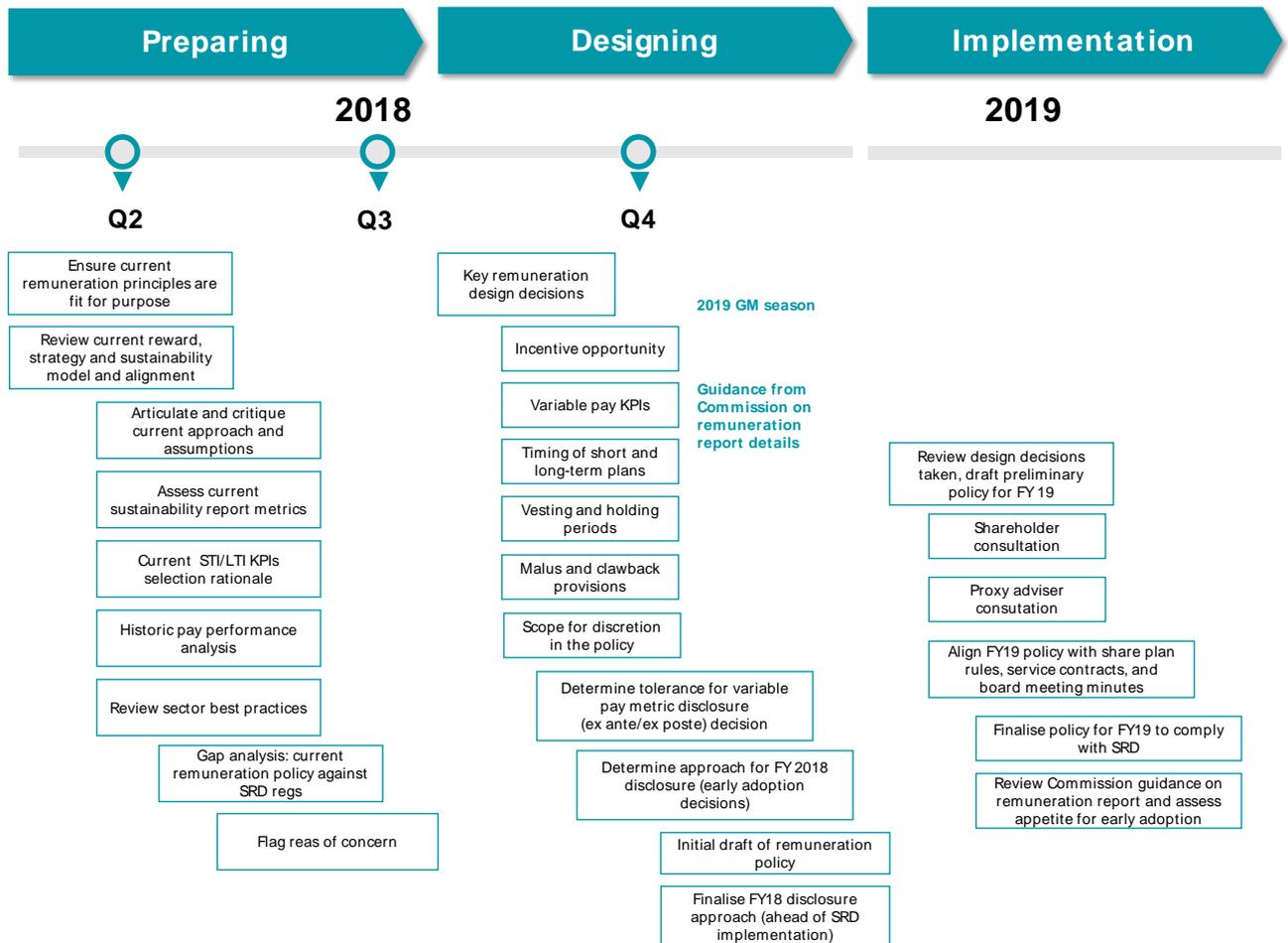
It is therefore likely that Remuneration Committee's within Swedish companies will have an increased time commitment to address the reporting and disclosure requirements of the SRD and to be actively involved in communicating and explaining remuneration policies and practices, particularly in respect of pay-performance outcomes. While we do not expect the revolutionary change that new regulations brought to the UK, it is clear that the SRD is a significant step-up from current Swedish reporting practices.

Be prepared

The July 2019 implementation date is fast approaching. We outline below the key steps companies can consider as they prepare for the revised remuneration policy requirements. As more guidance from the Commission is forthcoming, we will advise on remuneration reporting considerations.

An approach for preparing for the SRD remuneration policy

The approach shown below is based on a proactive model that seeks to address the challenges of the SRD early rather than waiting until 2019 to take action.



It is important to plan early and take a view as to how 2018 remuneration disclosures, under current reporting requirements, will evolve ahead of the SRD implementation. Companies should therefore engage with all stakeholders in good time internally, engage shareholders and proxy advisers, and be prepared for changes during the drafting process. The SRD represents a challenge for companies to improve communication and transparency, taking a cautious view on voluntary disclosures and aligning policies share plan rules, service contracts, and board meeting minutes.

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