REMUNERATION POLICIES

Having a say on pay

New legislation has been introduced in Israel to limit the pay packets of senior executives

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While the UK press has widely reported on 'fat cat' salaries and exorbitant bonuses of some of the most senior employees of public companies in the UK, in Israel new legislation has been introduced to curb such excesses and limit and control the monies that have been pouring into the pockets of senior executives.

Following on from the wide-ranging social protests in Israel of 2011 (triggered initially by an increase in the price of cottage cheese), two amendments were adopted to the Israeli Companies Law (1999) which together form a 'revolution' in the regulation of compensation packages available to office holders of public companies.

Under Amendment 20, a public company is now required to establish an independent remuneration committee, formulate a compensation policy and have such policy adopted by both its board of directors and a special majority of its shareholders.

It is the task of the remuneration committee to draw up the compensation policy. To ensure due thought is given and to prevent a simple repackaging of the status quo, the new law sets forth a list of factors to be considered when crafting such policy; for example, the officer's education, experience, accomplishments, position, responsibility and past terms of engagement. Notably, the committee is required to consider the ratio between an officer's employment conditions and those of the rest of the company's employees, particularly the average salary, and the effect such differences may have on the company's labour relations. Retirement grants should bear relation to each officer's contribution to the achievement of the company's goals and profitability and the circumstances of their retirement, and such amounts should be capped.

The remuneration committee is to be comprised of members of the company's board of directors. However, in the interest of preserving independence and objectivity, the new committee must include all the external directors of the company, who must constitute a majority of its members. Moreover, all members of the committee are to be paid on the same terms as external directors.

The new legislation is built on the 'say on pay' mechanism adopted in other countries around the world. The general rule under the new law is that where the officers' terms of engagement comply with the compensation policy, no further shareholder approval is required – after all they previously had their say. However, as with every rule there are exceptions, and the terms of engagement of a CEO, directors and controlling shareholders require additional shareholder approval and in certain cases special majority approval. Furthermore, the terms of engagement of any controlling shareholder must be re-approved by the shareholders every three years.

Interestingly the law provides a set of rules that apply when circumventing the limits of the compensation policy. It dictates that where the terms of an officer's engagement derogate from the adopted policy, the approval of a special majority of shareholders is required. Moreover, with respect to the engagement terms of controlling shareholders, the board is required to first weigh the matters listed for consideration by the remuneration committee in authoring the compensation policy, before recommending such terms to the shareholders.

Where the shareholders have exercised their 'say on pay' and elected not to approve certain terms, the matter will be returned to the remuneration committee and the board. Curiously, at such time the board can simply, by stating its reasons, overrule the decision and will of the shareholders. Additionally, the remuneration committee may exempt the engagement terms of an independent CEO candidate that comply with the compensation policy from requiring shareholder approval, if the committee believes the shareholders will frustrate the transaction. But would a director, with one eye on his fiduciary duty, take such decisions lightly?

Amendment 20 was published in November 2012 and swiftly came into force in December 2012, causing some uncertainty. Public companies have until August 2013 to adopt a compensation policy; in the meantime all engagements of senior officers require shareholder approval.

Given the fierce competition to recruit and retain top management only time will tell if public companies can devise creative ways to bypass these restrictions and what level of activism the securities authorities will take in enforcing the new requirements.

Is the new law simply election politics, perfectly timed to be published and enter into force just before the national polls in January, or does it reflect a real revolution in corporate governance?

It has been reported that in the month between publication of the amendment and it coming into force, the Israeli Securities Authority was already adopting an aggressive approach, armed with a barrage of questions on how the boards of public companies had exercised their discretion in offering compensation packages to their senior officers.

Indeed, on the eve of the amendment's implementation, the terms of some of the higher paid officers in Israeli public companies were rushed through the then applicable approval processes. Some people at least would appear to be concerned by the new law.

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