AGENT INCENTIVES

Corporate laws support market practices pointed to align managers behaviors and shareholders interests by using a combination of low-powered (trusteeships strategies) and high-powered (reward strategies) incentives.

TRUSTEESHIP STRATEGY: INDEPENDENT DIRECTORS

- independent director: not tied by high powered economic incentives, motivated by ethical and reputational concerns, not involved in the day to day operations (non executive)

- independent directors are expected to exercise judgment insulated from management influence, but their effectiveness varies widely across jurisdictions depending on ownership structures and legal traditions.

- independent directors are deployed to protect majority shareholders vis a vis managers, as well minority shareholders and other stakeholders

In EU jurisdictions with concentrated ownership, independent directors play a crucial role in protecting minority investors and constraining controlling shareholders.

- even if all of the jurisdictions provide the appointment of independent directors, nevertheless there are not systems which rely only on trusteeship strategy

- independent directors have a great part in the key committees of the corporations (audit, compensation, nomination)

In the U.S., board committees operationalize monitoring, while EU codes similarly emphasize independent-led committees for listed companies.

US corporations have independent directors according to US case law :

- according to the US exchange rules the majority of directors must be independent

- Sarbanes-Oxley Act of 2002 requires publicly traded companies to have wholly independent audit committee which selects outside auditors

- with the Dodd-Frank Act of 2010 US law sets forth wholly independent compensation committees

- EU jurisdictions rely on codes of best practices = independent directors

following UK now all EU jurisdictions have adopted a code of best practices. but only for listed companies

- SOFT LAW = companies are not obliged but must explain if they do not comply (COMPLY or EXPLAIN RULE)

Soft law responds to heterogeneity across European markets, allowing flexibility through the comply-or-explain mechanism.

- independent directors are not always independent as they are appointed by the majority shareholders!

Independence is functional, not merely formal; social and economic ties may compromise effective monitoring.

ONE SIZE DOES NOT FIT ALL = explanation for the choice of “soft law”!

one size does not fit all” means that rigid, uniform rules cannot effectively address the diverse ownership structures, sizes, and strategic contexts of different companies.

Soft law allows flexibility, enabling firms to adapt principles—such as remuneration guidelines or incentive frameworks—to their specific circumstances while still promoting transparency, accountability, and alignment between managers and shareholders.

- US picked “hard law”: listing rules, federal law + courts independent directors are increasingly more

- JAPAN (Tokyo Stock Exchange): board made of inside managers monitored by a board of auditors- but there is a trend of increasing number of independent directors (one or two)

Japan has progressively increased independent director requirements, reflecting a trend toward global convergence.

Brazilian law does not mandate the appointment of independent directors but a minimum of 20% independent directors is provided by the Săo Paulo Stock Exchange rules

The Brazilian Novo Mercado imposes stricter independent director requirements to enhance investor protection.

- trustee-like directors are key elements of good governance

- independent directors do not know much about the company, reason why the law, mainly for financial institutions, requires specific skills for directors instead a mere independence

REWARD STRATEGY

N.B. optimally structured pay packages can align managers and shareholders interests, then reducing monitoring costs for shareholders

Reward strategies substitute for shareholder monitoring in dispersed-ownership systems where coordination costs are high.

- Equity based compensations: recent restriction in US /no loan - no deduction over 1 million + no equity compensation for State subsidized corporations

Equity compensation may induce risk-taking, leading to post-crisis reforms introducing clawbacks and transparency requirements.

- the correct calibration of directors compensation relies on compensation committees composed, sometime entirely (US), by independent directors

- cases EISNER - ACKERMANN

Both cases illustrate how executive reward strategies, when disconnected from long-term value creation, become vulnerable to legal and governance criticism.

They show that compensation structures lacking clear performance justification, board oversight, or shareholder alignment make executive pay arguably excessive, raising issues of fiduciary duty, fairness, and legitimacy under corporate-law standards.

Judicial deference in EISNER and ACKERMANN illustrates the difficulty of challenging board-approved pay.

The CEO pay ratio disclosure

CEO pay ratio disclosure is a U.S. Securities and Exchange Commission (SEC) requirement for public companies to report the ratio of their CEO's total annual compensation to the median employee's total annual compensation. Enacted by the Dodd-Frank Act, this rule aims to provide transparency on pay equity by comparing CEO pay to the pay of a median employee, with the first disclosures occurring in 2018. The rule does not apply to certain companies, such as small reporting companies and foreign private issuers.

The UK requires large listed companies (with 250+ UK employees) to disclose the ratio of CEO pay to pay at the 25th, 50th (median), and 75th percentiles of UK employees.

They must also explain the methodology used and provide context for year-to-year changes.

The goal is to increase transparency and show how executive pay compares with typical workforce pay.

As of 2023, the EU Pay Transparency Directive (EUPTD) has been approved by EU institutions. The aim is to enhance pay transparency across member states.

Among other provisions (gender pay gap reporting; banning pay history inquiries; right for employees to access pay information; job-advertisement pay-range disclosure), the Directive encourages or mandates forms of transparency that could implicitly or explicitly facilitate — in effect — more scrutiny over overall pay inequality within firms.

Europe is “playing catch-up”: more firms are starting to provide voluntary pay-ratio disclosure, sometimes as part of ESG / human capital management reports.

LEGAL CONSTRAINTS

DUTY OF CARE

Fiduciary duties differ in enforcement: the U.S. BJR is highly protective compared to civil-law jurisdictions.

Duty of care is a fiduciary responsibility for company directors that requires them to make decisions in good faith and in a reasonably prudent manner. The duty of care requires directors to make business decisions after taking all available information into account, and then act in a judicious manner that promotes the company's best interests. Directors are required to exercise the utmost care in making business decisions in order to fulfill their fiduciary duty.

It is very relevant to assess the correct process of decision making through obtaining adequate advice

the business judgment rule: Given that the directors cannot ensure corporate success, the business judgment rule specifies that the court will not review the business decisions of directors who performed their duties (1) in good faith; (2) with the care that an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the directors reasonably believe to be in the best interests of the corporation.

As part of their duty of care, directors have a duty not to waste corporate assets by overpaying for property or employment services. The business judgment rule is very difficult to overcome and courts will not interfere with directors unless it is clear that they are guilty of fraud or misappropriation of the corporate funds

BJR prevents hindsight bias but limits litigation as a governance tool.

DUTY OF LOYALTY

Duty of loyalty enforcement is critical to prevent tunneling and protect minority shareholders in concentrated-ownership systems.

Duty of loyalty is a directors' responsibility to act at all times in the best interests of their company. The duty of loyalty is one of the two primary fiduciary duties required to be discharged by a company's directors, the other being the duty of care. The duty of loyalty requires a director to be completely loyal to the company at all times. It also imposes the responsibility to avoid possible conflicts of interest, thereby precluding a director from self-dealing or taking advantage of a corporate opportunity for personal gain.

CORPORATE GOVERNANCE-related disclosure

Extensive public disclosure contributes to the quality of corporate governance

Great convergence among our core jurisdictions on mandatory disclosure for listed companies

Through mandatory disclosure the market becomes a monitor of the performances of the public corporations.

Disclosure serves as a market-based monitoring mechanism, allowing investors to discipline corporate insiders.

The possible subjects of mandatory disclosure: ownership structure, shareholding agreements, executive compensations, related parties transactions, board composition