

2016 Report by the AMF on Corporate Governance and Executive Remuneration

Reference Texts: Articles L. 225-37, L. 225-68, L. 225-102-1, L. 225-185, L. 225-197-1, L. 823-19, and L. 823-20 of the Commercial Code; Article L. 621-18-3 of the Monetary and Financial Code

Summary

I - Overview

This report was drafted pursuant to Article L. 621-18-3 of the French Monetary and Financial Code, which requires that the French Financial Market Authority (AMF) prepare a report each year on corporate governance, executive remuneration and internal control, based on the information published by legal persons whose shares are traded on a regulated market and who are headquartered in France. This is the 13th such report written by the AMF.

Beyond the legal requirements under corporate law, the system of corporate governance regulation and executive remuneration practices is rather broadly based on the implementation of codes developed by organisations representing the companies and on the "comply or explain" principle, as per Articles L. 225-37 and L. 225-68 of the French Commercial Code¹. This principle holds a structural place in the current system but can be interpreted in various ways. Thus, an assessment of its scope and of the relevance of explanations provided by companies is a decisive factor in evaluating governance. The AFEP-MEDEF Code has adopted a strict concept of this principle since 2013, consistent with the AMF's.

In 2016, in order to increase the visibility of the most important elements and follow in the footsteps of other European regulators, the AMF decided to present the report in a more succinct format. The statistical analysis and comments relating to the practices of surveyed companies are now focused around topics that have been chosen primarily on their regulatory relevance. Changes during the year to the corporate governance and remuneration system are presented largely in the form of summary tables.

The report's analysis sample consists of 35 companies registered under French law and members of the CAC 40 as at 31 December 2015, of two companies that were part of the mentioned index as at 31 December 2014, and of 25 other companies of the SBF 120 with the smallest capitalisations.

With regard to corporate governance, the AMF notices ongoing progress in board member diversity, specifically the proportion of women, who made up 35.2% of boards on 31 December 2015, compared with 31.5% on 31 December 2014 and 28% on 31 December 2013. There are 14 companies with boards consisting of female independent directors. However, there is a significant gap between female representation on boards, which is required by law, and their presence in corporate officer positions (chairman, CEO, COO), which remains very low. Only three surveyed companies had a woman as chairman and CEO (the position known in French as the PDG) or CEO, while two others had a female chairman. On the 30 of the surveyed companies, the AMF notes that at least one of the board committees was chaired by a woman.

Sixteen companies report to have they had appointed at least one director representing employee shareholders in 2015, and 29 firms said they had appointed a non-shareholding employee as a director. However, only 19 of them had appointed a non-shareholding employee director to the remuneration committee, as recommended by Article 18.1 of the AFEP-MEDEF Code. The total proportion of independent directors within the boards (61% in 2015) remains high. However, the AMF notes that 10 surveyed companies provided no information on the criteria they used to appraise the significance of

¹ Respectively, for companies with a board of directors and for those with a supervisory board and an executive board.

business relationships. For investors to be able to assess the independent status of directors, companies must present in their annual report, in compliance with the AFEP-MEDEF Code recommendation, the criteria used by the board of directors or supervisory board to appraise the significance of the business relationships between their independent board members and the company of which they are directors or supervisory board members. It should be remembered that a significant business relationship represents, in itself, a conflict of interests.

All the surveyed companies complied with the AFEP-MEDEF Code recommendation on declaring conflicts of interest. Only two companies made no mention of specific conflict-of-interest rules for directors. In 2015 as in 2014, 95% of companies with a lead director appointed an independent to this role. The AMF also notes that the executives at two surveyed companies failed to comply with the AFEP-MEDEF Code recommended limit of three mandates for executive directors. Likewise, 45% of companies did not state that corporate officers (executive or otherwise) had to consult the board before accepting an office in a French or foreign non-Group listed company. Lastly, 17 surveyed companies (of which only 8 were on the CAC 40 compared with 13 in 2012) had appointed non-voting directors in 2015.

In some cases, the AMF noticed that conflicts of interest might be the cause of disagreements between companies and their shareholders. They emerged because of a lack of transparency or adequate procedures for preventing and rectifying such conflicts. Although the matter is not widely dealt with by current regulations, conflicts of interest between companies and their shareholders are discussed in more detail in this report. In fact, there is no precise definition in financial law of the concept of conflicts of interest. Clearly, there are specific legislative provisions aimed at preventing certain conflicts of interest by withholding voting rights from any direct or indirect beneficiary of a decision taken at a shareholders' meeting (Art. L. 225-138 of the French Commercial Code² for reserved capital increases, Arts. L. 225-38³ and L. 225-40⁴ for regulated agreements), but these provisions neither cover all possible scenarios nor guarantee overall consistency in dealing with conflicts of interest. In particular, these scenarios concern capital increases that are reserved for certain categories of beneficiary, service concession arrangements (including management fees) and arrangements regarding the sale or acquisition of a significant asset. In this regard, the AMF notes shortcomings in relation to corporate governance, particularly when provisions which in theory protect minority shareholders from potentially harmful transactions are, in practice, circumvented. Regulated agreements are sometimes ratified with a narrow reading of the notion of an "indirectly involved person". The AMF reaffirms that it used a broader definition of this notion in its Recommendation 2012-05 as amended in February 2015⁵, and has called for greater transparency on the grounds for these agreements, their financial terms and conditions and, where applicable, the fairness opinions used during their approval by the shareholders' meeting.

Regarding to the remuneration of executive directors and corporate officers, the AMF notes that the recommendations from both the AFEP-MEDEF Code and Recommendation 2012-02 have been broadly implemented. Only one surveyed company failed to justify the retention of one its executives, and two companies failed to justify the increase in fixed remuneration for some of their executives. In total, 93% of surveyed companies (97% of those on the CAC 40) offered some form of variable remuneration. 90% of surveyed companies have abided by the rule on caps and description of qualitative criteria. However, there was less compliance with recommendations on the description of qualitative criteria: 72% of

² Article L.225-138 of the French Commercial Code states: "*The general meeting that decides on the capital increase may reserve it for one or more persons specifically named or for categories of persons that meet determined characteristics. To this end, it may cancel the preferential subscription right. **The specifically named persons who benefit from this arrangement may not take part in voting. The quorum and majority required are calculated after deduction of the shares held by such persons.***"

³ Article L. 225-38 of the French Commercial Code states: "*Any agreement entered into, either directly or through an intermediary, between the company and its CEO, one of its COOs, one of its directors, one of its shareholders holding more than 10% of voting rights or, in the case of a corporate shareholder, the company which controls it within the meaning of Article L. 233-3, must be subject to the prior consent of the board of directors.*"

⁴ With regard to authorisation from the shareholders' meeting, Article L. 225-40 of the French Commercial Code states: "*The interested party may not participate in the vote and his shares shall not be taken into account for the calculation of the quorum and the majority.*"

⁵ Recommendation updated following the progress report published in February 2015 regarding implementation of the proposals and recommendations featuring in the July 2012 working group's report on listed companies' shareholders' meetings.

surveyed companies provided a description of them (84% of those on the CAC 40) and 66% disclosed the applicable distribution key (69% of those on the CAC 40). In addition, when examining registration documents from 2015, the AMF uncovered two companies⁶ whose appraisal of performance associated with long-term remuneration could be called into question.

Lastly, regarding the say on pay, all surveyed companies put executive remuneration resolutions before their shareholders' meetings. For the first time ever, shareholders at two of these companies refused to adopt the resolutions.

All in all, five new recommendations have been made on remuneration (see Annex 2), to complement those in Recommendation DOC-2012-02⁷.

II – Report methodology

2.1 Report approach and structure

This report uses the following approach and structure:

- the main changes to the regulatory environment of corporate governance for listed companies are presented in the third part of the report, primarily in summary tables;
- in view of its importance as part of corporate governance, compliance with the comply or explain principle, as set forth in Articles L. 225-37 and L. 225-68 of the French Commercial Code⁸, is subject to rigorous examination, in accordance with AMF policy and the AFEP-MEDEF Code;
- the statistical and compliance analysis and information concerns only certain topics in order to increase the visibility of the most important messages, to make the report more coherent and to make it more complementary to existing documents, particularly those produced by the High Committee on Corporate Governance (HCGE);
- the **best and worst practices** of certain issuers are always highlighted, and the companies in question are named in the report. Mention is also made of companies that fail to apply an AFEP-MEDEF Code recommendation or an AMF recommendation (particularly one interpreting a measure from the AFEP-MEDEF Code) and fail to provide sufficiently qualified or suitable explanations, in accordance with the comply or explain principle. The AMF also observed certain practices at non-surveyed companies in order to establish a more complete picture of the year's corporate governance practices.

2.2 Scope and sample

Scope of the report

The AMF's annual report on corporate governance and executive remuneration aims at providing a snapshot of transparency and compliance among the main listed companies with regard to the AFEP-MEDEF Code recommendations, at presenting best practices in the field, and at promoting the development of corporate governance by making recommendations for issuers and, where necessary, raising issues with the Code creators.

⁶ One of these firms was not part of the survey. It was upon examining its 2015 registration document that its situation was deemed sufficiently significant for inclusion in this report.

⁷ AMF Recommendation DOC-2012-02 - Corporate governance and executive remuneration in companies referring to the AFEP/MEDEF Code – Consolidated presentation of the recommendations contained in the AMF annual reports.

⁸ Respectively, for companies with a board of directors and for those with a supervisory board and an executive board.

Paragraph 7 of Article L. 225-37 of the French Commercial Code states: "*When a company refers voluntarily to a code of corporate governance drawn up by organisations representing companies, the report specified in this article shall also set out the provisions that have been ruled out and the reason for this decision. The report shall also specify the place where this code may be consulted. If a company does not refer to such a code of corporate governance, this report shall indicate the rules used in addition to the legal requirements and state the reasons why the company has decided not to apply any provision of this code of corporate governance.*"

All the information contained in this report has been published by the issuers in their registration document or 2015 annual report published in 2016, in press releases or in resolutions put before shareholders' meetings held in the first quarter of 2016.

Sample of 62 companies

The sample used to draw up this report (see Annex 1) is made up of 62 companies listed in Euronext's A compartment and referring exclusively to the corporate governance code prepared by AFEP and MEDEF. It breaks down as follows:

- **35 French-law companies** featuring on the CAC 40 index as at 31 December 2015. **Two companies**, EDF and UNIBAIL-RODAMCO, were also included since they were part of the CAC 40 at 31 December 2014 but came off the index in 2015. By having these companies in the sample, we can present a statistical comparison of the corporate governance and executive remuneration information provided by the main listed companies. The scope of analysis does not include the five CAC 40 companies whose headquarter is located outside France⁹;
- **25 other SBF 120 companies** with the smallest capitalisation, unlike the sample for the previous three years' reports, which contained the SBF 120 companies with the largest capitalisation after those on the CAC 40, with the aim being to analyse practices at companies not previously studied by the AMF for the purpose of its report.

As in 2015, some companies with a non-calendar financial year¹⁰ were included in the sample.

III- NEW RECOMMENDATIONS ON REMUNERATION

General observations - presentation:

The AMF recommends that companies ensure that the explanations provided to justify certain elements of the remuneration awarded to executive corporate officers for a given year, even if they have already been disclosed to investors (in the previous year's registration document or annual report, press releases or website posts), are reiterated in the registration document or annual report for the year under review in order to guarantee that the information supplied is exhaustive and clear.

Variable remuneration:

The AMF recommends that companies:

- state whether each criterion they use is qualitative or quantitative;
- indicate the cap on variable remuneration, either as a percentage of fixed remuneration or a maximum amount if no fixed remuneration is awarded;
- if they apply adjustment clauses that affect the calculation or payment of certain elements of remuneration, provide clear and precise information on how these clauses are implemented and ensure that the pre-established nature of the criteria used to identify these elements is not called into question.

Say on pay:

The AMF recommends that companies with a resolution referring to a document outlining the elements of remuneration put to a shareholder vote make a precise reference to said document in order to ensure that shareholders can easily access the information required.

⁹ As at 31 December 2015, these were: AIRBUS GROUP, ARCELORMITTAL, GEMALTO, LAFARGEHOLCIM and SOLVAY.

¹⁰ ALSTOM and PERNOD-RICARD.