ISS FAQ: Say-on-Pay Remuneration Changes

France

2014

Report Author
Eva Chauvet
eva.chauvet@issgovernance.com

ISS

An MSCI Brand

Introduction

This report provides information on the new recommendations in France relating to say-on-pay voting on executive corporate officers' remuneration, and on the approach that ISS is intending to take in its French benchmark policy research and voting recommendations.

Say-on-pay votes are not compulsory under the French Commercial code. Say-on-pay votes result from a new recommendation set by the most commonly used code of best practices in France, the amended version of the AFEP-MEDEF Code published in June 2013.

The AFEP-MEDEF Code recommends, as of 2014 AGMs, the filing of annual advisory say-on-pay resolutions targeting the elements of the (due, received, or awarded) compensation of each executive corporate officer with respect to the fiscal year under review. An application guide published by AFEP and MEDEF in January 2014 specifies that this vote shall address all compensation whether granted by the issuer or by any other company of the same group.

However, it also should be noted that the French Commercial Code provides issuers with a choice of which code to refer to. While most large French issuers refer to the AFEP-MEDEF Code, the MiddleNext Code, which specifically targets small- and mid-caps, does not recommend any vote on remuneration. In such cases, as well as in the cases of issuers having chosen not to refer to any code, no say-on-pay proposals should be expected.

What Companies Are Impacted and From When?

Which companies will ISS expect to give a say-on-pay vote?

ISS expects that all French companies that have designated the AFEP-MEDEF Code as code of reference, whatever their legal structure is (i.e., public limited company with a one-tiered board structure or a two-tiered board structure, partnership limited by shares, or European company), will provide such say-on-pay resolution(s) at their AGMs to be held from Jan. 1, 2014.

For French companies that have chosen not to refer to the AFEP-MEDEF Code, ISS will note their choice of code (if any), but will still view giving shareholders a say-on-pay vote as best practice. ISS will analyze any say-on-pay resolutions proposed in the same way as for those who choose to refer to the AFEP-MEDEF Code.

Which corporate officers are concerned?

ISS expects that say-on-pay resolutions will cover remuneration to the following beneficiaries (regardless of whether they held their positions with the issuer during the entire fiscal year under review):

- The CEO or the chairman of the management board or the general manager (or its permanent representative), individually;
- The vice-CEO(s) or the other member(s) of the management board, individually or collectively;
- Any other executive corporate officer(s) (e.g., the chairman of the board of directors) designated as such by the issuer, individually or collectively;
- Any other corporate officer(s) (e.g., the chairman of the supervisory board) whose compensation is proposed to shareholders' vote, individually or collectively.

What is the vote requirement?

This proposal requires the approval of a simple majority of votes cast (i.e., 50 percent plus one vote). As for all resolutions on the French market, abstentions are counted as against votes for the calculation of the approval rate.

What happens if the resolution is defeated?

Although the shareholder vote will just be advisory and not binding, in the event of a negative vote decision (meaning, according to the application guide published by AFEP and MEDEF, that the resolution is defeated) on the proposed remuneration, the board should consult the remuneration committee and then debate the matter during a subsequent board meeting to decide on any actions to be taken in response to the shareholder vote. The board should immediately thereafter issue a press release and post it to the company's website explaining its intended response to the shareholder vote.

ISS' General Approach for France

How will ISS analyze say-on-pay resolutions for French companies?

ISS will analyze all say-on-pay resolutions according to ISS European Policy and, in particular, in light of the five ISS Global Principles on Executive and Director Compensation described below (in the Appendix section). This analysis will be made on a case-by-case basis, taking into consideration the comply-or-explain principle strengthened by the amended version of the AFEP-MEDEF Code published in June 2013.

However, as the recommendation for such a vote is new in France, ISS will also view 2014 as an interim period, and will in 2014 consider the extent to which companies are making progress toward best practice, both with reference to the AFEP-MEDEF Code and in light of the ISS Global Principles described below.

Therefore, as regards the scope of ISS' analysis and the resulting vote recommendations, a distinction can be made between AGMs held up to Jan. 31, 2015, and AGMs held from Feb. 1, 2015.

The same framework will be applied to any say-on-pay resolutions proposed by French companies that have chosen not to refer to the AFEP-MEDEF Code.

ISS' Approach for AGMs Held Up to Jan. 31, 2015

What is the scope of ISS' analysis for AGMs held up to Jan. 31, 2015?

For the AGMs convened in 2014 and January 2015, ISS will mainly focus on (i) the quality of the disclosure provided by the issuer for the fiscal year under review (as well as, concerning certain points, the previous fiscal year), meaning that clear, comprehensive, and relevant information on compensation shall be made publicly available, and (ii) the compliance during the fiscal year under review of the compensation-related practices of the issuer with key points of the policy which have been continuously applied by ISS on the French market for several years.

The scope of ISS' analysis will consequently be twofold:

1. Quality of disclosure

ISS will point out any lack of disclosure reflecting a practice below French market standards.

An issuer shall disclose compensation-related elements granted by any companies of its group in connection with each of its executive corporate officers, notably:

- The remuneration policy for the fiscal year under review, including principles, structure, and explanation of the evolution of the compensation - notably the rationale behind an increase in the base salary - over the past few years; definition and description of each of the components of the compensation, including any mechanisms spread over several years and any terms and conditions attached; rationale behind the choice of a remuneration via consulting fees; and nature, metrics, level of fulfillment, and weighting of any qualitative and quantitative pre-determined performance criteria, target, and cap of the bonus as a percentage of the base salary. For partnerships limited by shares, ISS will take into consideration specificities linked to the general manager's compensation (i.e., setting of the base salary and of the bonus resulting from bylaws' provisions);
- The breakdown of the amounts received and due (either in cash or in shares) with respect to the fiscal year under review, and with respect to the previous year, for each component of the compensation, as described in the tables recommended by the AMF and the AFEP-MEDEF Code published in June 2013. To be included, among others, are base salary, annual and multiannual target bonus, deferred bonus, perquisites, indemnities of any kind, exceptional remuneration, consulting fees (e.g., management fees paid via a company held/controlled by the concerned executive corporate officer), golden hello, and severance package actually paid or whose payment's principle was decided by the board regardless of whether this package results from the termination of a corporate officer mandate or of an employment agreement;
- The number of stock-options, warrants, and performance shares awarded during the fiscal year under review as well as, notably, their valuation, the vesting period, the nature and the metrics of the performance conditions attached, the performance period, and, for stock-options and warrants, the exercise price;
- The number of stock-options and warrants exercised and the number of performance shares acquired during the fiscal year under review, as well as, notably, the nature, the metrics, and the actual level of achievement of the performance conditions attached;
- The terms and conditions of any new or ongoing post-mandate remuneration (notably, termination package and/or additional pension scheme), including under potentially suspended employment agreements.

AND

2. Absence of egregious practices

An issuer shall not have maintained egregious compensation-related practices during the fiscal year under review. Such practices are those that strongly contradict any of the five ISS Global Principles on Executive and Director Compensation described below (in the "Appendix" section), and/or reflect a practice far below par in relation to French market standards.

Examples of key points continuously considered by ISS as a breach of French market standards for several years:

- Executive or cross-directorship on remuneration committee;
- Unjustified significant base salary increases;
- No cap on annual variable remuneration;
- Unjustified "exceptional" bonuses;
- Bonus' award not entirely subject to performance condition(s);
- Retroactive setting by the board of the base salary and/or of the targets attached to the bonus;
- "Golden hello" not subject to conditions;
- Ongoing termination package exceeding 24 months' base salary and bonus when not submitted to shareholders' vote on a regular basis or termination package due in connection with the fiscal year under review exceeding 24 months' base salary and bonus;
- Potential accelerated vesting when departure of the executive not submitted to shareholders' vote on a regular basis or accelerated vesting following executive's actual departure;
- Absence of performance condition(s) attached to stock-based plan(s) awarded to executive corporate officer(s) during the fiscal year under review.

What would be ISS' voting recommendation on a say-on-pay resolution up to Jan. 31, 2015?

Until January 2015, ISS will generally consider a negative recommendation is warranted on a say-on-pay resolution if the issuer does not significantly comply with the two major factors of level of disclosure and absence of egregious practices, as described above.

ISS will generally consider a positive recommendation is warranted on a say-on-pay resolution if the issuer has a satisfactory level of disclosure to shareholders and an absence of egregious practices.

ISS will also be focused on any actual significant improvement in issuer's practices and/or disclosure in respect with the fiscal year under review as well as on any commitment publicly made by the issuer to significantly improve its practices and/or disclosure from the current fiscal year. ISS may or may not decide to take such improvement or commitment to improve into account in its vote recommendation, depending on its significance, and, on this basis, may consider issuing a qualified support on a say-on-pay resolution in some cases where the disclosure or practices are not fully in line with French market standards if significant improvements are considered to warrant such support.

ISS' Approach for AGMs Held after Jan. 31, 2015

What will be the scope of ISS' analysis for AGMs held after Jan. 31, 2015?

ISS will undertake a 2014 post-season review of compensation practices and voting outcomes in France to consider progress made and issues encountered. Thereafter, ISS expects to further extend its approach beyond disclosure and egregious practices, moving toward a full implementation of the five ISS Global Principles on Executive and Director Compensation described below (in the "Appendix" section), starting with the AGMs to be convened after Jan.

31, 2015. As is our normal practice, ISS will communicate in advance the exact nature of the changes in the scope of say-on-pay analysis for 2015.

Reference to the AFEP-MEDEF Code

What ISS' position would be in the event that an issuer referring to the AFEP-MEDEF Code does not propose a say-on-pay vote?

A vote on executive compensation is one of the major improvements introduced by the amended AFEP-MEDEF Code published in June 2013 as a result of the French government's decision not to introduce such vote by law but to task issuers' associations with its implementation.

In the meantime, the comply-or-explain principle was introduced by the AFEP-MEDEF Code. However, ISS considers it unlikely that any explanation could justify a situation whereby an issuer referring to this code would fail to propose a say-on-pay vote. Therefore, in the event that an issuer does not comply with the AFEP-MEDEF Code recommendation on say-on-pay, ISS will generally recommend a vote AGAINST the approval of the annual financial statements and, if filed to the AGM agenda, the reelection of the chairman of the compensation committee.

Considering this specified legal structure, ISS may consider adopting a less stringent position for partnerships limited by shares if they provide a strong rationale for such a non-compliance with the code, and that rationale is considered justified.

What would ISS' position be in case of change in the code of reference?

The French Commercial Code provides that the choice of their code of reference belongs to issuers. Most of the time they refer either to the AFEP-MEDEF Code, which has recommended an annual advisory say-on-pay vote since its amended version was published in June 2013, or to the 2009 MiddleNext Code, which specifically targets small- and mid-caps and does not recommend any vote on compensation. In the event that an issuer would decide to soften the corporate governance framework, including compensation-related matters, to which it refers by switching from the AFEP-MEDEF Code to the MiddleNext Code, shareholders may no longer get a say-on-pay vote.

Such a change would therefore deprive shareholders of the right to express a view on executive compensation. Apart from the case when the issuer provides a compelling rationale (accurate, relevant, and specific to the issuer's situation) for its new code endorsement, ISS will generally recommend a vote AGAINST the approval of the annual financial statements and, if filed to the AGM agenda, the reelection of the chairman of the compensation committee.

ISS may change its future position in the event that the MiddleNext Code would be amended to integrate a recommendation on shareholders' vote on executive compensation.

Combination with Other Items Filed on the Agenda

Will there be any link between say-on-pay resolutions and LTIP resolutions proposed at the same AGM?

Say-on-pay resolution(s) will be analyzed separately from resolution(s) authorizing the implementation of stock-based plan(s) proposed at the same AGM.

The analysis of a say-on-pay on the French market addresses mainly issuer's past practices, including those on stock-based plans (i.e., stock-options/performance shares/warrants both awarded and exercised/acquired during the year under review), while the analysis of any stock-options/performance shares/warrants resolutions concerns future plans and all potential beneficiaries across the group. Therefore, ISS' analysis of resolutions on future stock-based plan(s) proposed for shareholders' vote will have as such no necessary impact on

ISS' analysis of say-on-pay resolutions also proposed at the same AGM (and *vice-versa*).

When will post-mandate remuneration (or equivalent) be taken into consideration in the analysis of a say-on-pay resolution?

"Post-mandate remuneration (or equivalent)" shall be understood as severance payments (regardless of what their nature is), remuneration of a non-compete clause, additional pension scheme, or treatment of unvested equity-based remuneration after termination.

At each AGM when a related-party transaction on a post-mandate remuneration (or equivalent) is separately proposed to shareholders' vote (notably to comply with the French Commercial Code provision on severance payments requiring that a specific related item be filed on the agenda each time the executive mandate is renewed), its analysis will be made under this specific resolution and excluded from the analysis of the say-on-pay resolution.

Otherwise, when a potential post-mandate remuneration (or equivalent) is not submitted to shareholders' vote under a specific resolution, ISS will carry-out a less in-depth analysis of the ongoing transaction which will be made via a say-on-pay resolution. As already described in the "What is the scope of ISS' analysis for AGMs held up to Jan. 31, 2015?" section above, for the AGMs to be held until February 2015, ISS will therefore scrutinize the level of disclosure provided by the issuer and its compliance with key points of ISS' policy which have been continuously applied by ISS on the French market for several years. In compliance with information provided in the "What will be the scope of ISS' analysis for AGMs held as from February 2015?" section above, new key points may be added for AGMs to be held starting in February 2015.

Appendix

ISS Compensation Guidelines (Europe)

The assessment of compensation follows the ISS Global Principles on Executive and Director Compensation which are detailed below. These principles take into account global corporate governance best practice.

The ISS Global Principles on Compensation underlie market-specific policies in all markets:

1. Provide shareholders with clear, comprehensive compensation disclosures;

2. Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value;

3. Avoid arrangements that risk pay for failure;

4. Maintain an independent and effective compensation committee;

5. Avoid inappropriate pay to non-executive directors.

In line with European Commission Recommendation 2004/913/EC, ISS believes that seeking annual shareholder approval for a company's compensation policy is a positive corporate governance provision.

In applying the Five Global Principles, ISS has formulated European Compensation Guidelines which take into account local codes of governance, market best practice, and the Recommendations published by the European Commission. ISS analyzes compensation-related proposals based on the role of the beneficiaries and has therefore divided its executive and director compensation policy into two domains:

I. Executive compensation-related proposals; and

II. Non-executive director compensation-related proposals

Executive compensation-related proposals

ISS will evaluate management proposals seeking ratification of a company's executive compensation-related items on a case-by-case basis, and will generally recommend a vote against a company's compensation-related proposal if such proposal fails to comply with one or a combination of several of the global principles and their corresponding rules:

1. Provide shareholders with clear and comprehensive compensation disclosures:

1.1. Information on compensation-related proposals shall be made available to shareholders in a timely manner;

1.2. The level of disclosure of the proposed compensation policy shall be sufficient for shareholders to make an informed decision and shall be in line with what local market best practice standards dictate;

1.3. Companies shall adequately disclose all elements of the compensation, including:

1.3.1. Any short- or long-term compensation component must include a maximum award limit.

1.3.2. Long-term incentive plans must provide sufficient disclosure of (i) the exercise price/strike price (options); (ii) discount on grant; (iii) grant date/period; (iv) exercise/vesting period; and, if applicable, (v) performance criteria.

1.3.3. Discretionary payments, if applicable.

2. Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value:

2.1. The structure of the company's short-term incentive plan shall be appropriate.

2.1.1. The compensation policy must notably avoid guaranteed or discretionary compensation.

2.2. The structure of the company's long-term incentives shall be appropriate, including, but not limited to, dilution, vesting period, and, if applicable, performance conditions.

2.2.1. Equity-based plans or awards that are linked to long-term company performance will be evaluated using ISS' general policy for equity-based plans; and

2.2.2. For awards granted to executives, ISS will generally require a clear link between shareholder value and awards, and stringent performance-based elements.

2.3. The balance between short- and long-term variable compensation shall be appropriate

2.3.1. The company's executive compensation policy must notably avoid disproportionate focus on short-term variable element(s)

3. Avoid arrangements that risk "pay for failure":

3.1. The board shall demonstrate good stewardship of investor's interests regarding executive compensation practices.

3.1.1. There shall be a clear link between the company's performance and variable awards.

3.1.2. There shall not be significant discrepancies between the company's performance and real executive payouts.

3.1.3. The level of pay for the CEO and members of executive management should not be excessive relative to peers, company performance, and market practices.

3.1.4. Significant pay increases shall be explained by a detailed and compelling disclosure.

3.2. Severance pay agreements must not be in excess of (i) 24 months' pay or of (ii) any more restrictive provision pursuant to local legal requirements and/or market best practices.

3.3. Arrangements with a company executive regarding pensions and post-mandate exercise of equity-based awards must not result in an adverse impact on shareholders' interests or be misaligned with good market practices.

4. Maintain an independent and effective compensation committee:

4.1. No executives may serve on the compensation committee.

4.2. In certain markets the compensation committee shall be composed of a majority of independent members, as per ISS policies on director election and board or committee composition.

In addition to the above, ISS will generally recommend a vote against a compensation-related proposal if such proposal is in breach of any other supplemental market-specific ISS voting policies.

Non-Executive Director Compensation

5. Avoid inappropriate pay to non-executive directors.

ISS will generally recommend a vote for proposals to award cash fees to non-executive directors, and will otherwise:

Recommend a vote against where:

- Documents (including general meeting documents, annual report) provided prior to the general meeting do not mention fees paid to non-executive directors.
- Proposed amounts are excessive relative to other companies in the country or industry.
- The company intends to increase the fees excessively in comparison with market/sector practices, without stating compelling reasons that justify the increase.
- Proposals provide for the granting of stock options, or similarly structured equity-based compensation, to non-executive directors.
- Proposals introduce retirement benefits for non-executive directors.

And recommend a vote on a case-by-case basis where:

- Proposals include both cash and share-based components to non-executive directors.
- Proposals bundle compensation for both non-executive and executive directors into a single resolution.

ISS Compensation-Related Voting Sanctions (Europe)

Should a company be deemed to have egregious remuneration practices (as a result of one or a combination of several factors highlighted above) and has not followed market practice by submitting a resolution on executive compensation, vote against other "appropriate" resolutions as a mark of discontent against such practices.

An adverse vote recommendation could be applied to any of the following on a case-by case basis:

- 1. The (re)election of members of the remuneration committee;
- 2. The discharge of directors; or
- 3. The annual report and accounts.

Failure to propose a resolution on executive compensation to shareholders in a market where this is routine practice may, by itself, lead to one of the above adverse vote recommendations regardless of the companies remuneration practices.

This report is provided by Institutional Shareholder Services Inc. ("ISS"), an indirect wholly owned subsidiary of MSCI Inc. ("MSCI"). MSCI is a publicly traded company on the NYSE (Ticker: MSCI). As such, MSCI is not generally aware of whom its stockholders are at any given point in time. ISS has, however, established policies and procedures to restrict the involvement of any of MSCI's non-employee stockholders, their affiliates and board members in the content of ISS' reports. Neither MSCI's non-employee stockholders, their affiliates, nor MSCI's non-management board members are informed of the contents of any of ISS reports prior to their publication or dissemination. ISS makes its proxy voting policy formation process and summary proxy voting policies readily available to issuers, investors, and others on its public Web site (www.issgovernance.com/policy).

Issuers mentioned in this document may have purchased self-assessment tools and publications from ISS Corporate Services, Inc. (“ICS”), a wholly owned subsidiary of ISS, or ICS may have provided advisory or analytical services to the issuer. No employee of ICS played a role in the preparation of this document. Any issuer that is mentioned in this document may be a client of ISS, ICS, MSCI Inc., ISS’ parent company, or a subsidiary of MSCI Inc., or may be the parent of, or affiliated with, a client of ISS, ICS, MSCI Inc., or another MSCI Inc. subsidiary. If you are an ISS institutional client, you may inquire about any issuer's use of products and services from ICS by emailing disclosure@msci.com.

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the “Information”) are the property of ISS, its subsidiaries, or in some cases third-party suppliers. The Information may not be reproduced or disseminated in whole or in part without prior written permission of ISS.

The Information has not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), or a promotion or recommendation of, any security, financial product, or other investment vehicle or any trading strategy, and ISS does not endorse, approve, or otherwise express any opinion regarding any issuer, securities, financial products, or instruments or trading strategies.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information.

ISS MAKES NO EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION AND EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by law, in no event shall ISS have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits), or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited.