sodàli ALIGNING INTERESTS

Essere associés

Say on Pay: *Hurry up slowly!*

Remuneration issues remained central to the concerns of shareholders during the 2013 proxy season. All resolutions were approved in France but several large cap listed companies came close to having certain resolutions rejected when shareholders voted on stock options, performance share plans or on senior management severance payments.

Sensitive components of remuneration packages are already subject to a binding vote at the General Meeting, and new provisions have now been added to the AFEP-MEDEF Corporate Governance Code, including an annual advisory vote on the compensation of executive officers.

The practical implications of the "Say on Pay" policy should not go unnoticed.

Under the new system:

- Issuers will include a detailed presentation of the remuneration policy of executive officers in their annual reference document, grouping together all the required information in a specific Chapter, which will be prepared with the assistance of the Compensation Committee.
- According to the law, companies will continue to submit historical remuneration-related resolutions to a binding vote (related party transactions, severance payments, stock option and performance share plans).
- Now shareholders will also have an annual advisory vote on the remuneration elements (fixed, variable annual and multi-annual, pensions, stock options or performance shares) due or awarded for each executive officer for the year ended. The vote does not relate to the Chapter mentioned above.

It is crucial Institutional Investors have a clear and transparent understanding similar to other countries where Say on Pay is currently implemented, and that the advisory vote on a Remuneration Report links business strategy, remuneration policy and the compensation packages of executive officers. Furthermore, it is clear investors will analyse the remuneration of executive officers submitted for approval in light of the overall remuneration policy provided in the remuneration Chapter required by the French Corporate Governance Code. An illustration of the above point relates to the annual variable remuneration: how could shareholders approve the payment of a bonus, regardless of the amount, if the way it had been determined – performance criteria, objectives and targets to be reached – was not detailed in the Chapter or not in line with the company's policies?
In short, the rejection of the remuneration package of a corporate executive officer could be either the result of disapproval of the implementation of the remuneration policy set out in the Chapter or a criticism of the remuneration policy itself.

Scope

The French version of the “Say on Pay” (hereinafter “SOP”) policy broadens the scope of what is submitted to shareholder approval, including fixed, annual and multi-annual variable remuneration (phantom stocks, performance units, etc.), and the objectives involved in determining this variable component.

For several years French issuers have made continuous efforts to improve transparency; however, the following components might require further explanations:

- Regarding fixed compensation, won’t investors be eager to know (a posteriori) the selected criteria used for the comparison panel (benchmark) and the company’s position in the benchmarking relative to peer companies? Also, won’t investors be interested to compare the year-over-year increases in fixed remuneration of corporate executive officers and other employees in the company?
- Will annual bonuses of corporate officers attract as much attention as long-term incentive plans (“LTIP”)? Considering that LTIP components such as objectives, choice of performance criteria, allocation scale and success rates would require a more macro sensitive assessment – will this lead proxy advisors to request increased disclosure regarding annual and/or multi-annual variable remuneration parameters similar to stock option and performance share plans? Will shareholders accept that companies exclude themselves from revealing certain objectives set for corporate officers that they consider sensitive vis-à-vis their competitors?

Implementation

Several questions arise regarding the practical implementation of the French SOP policy:

- Will companies harmonise their practices regarding the drafting of the Chapter and the resolution that will be submitted to shareholder vote?
- Is there sufficient formalisation of the foundations and principles of the remuneration policy to enable the drafting of this Chapter?
- Given the specificities of the SOP “*à la française*”, can we properly anticipate the expectations of institutional investors and proxy advisors regarding these additional components?
- Faced with this new challenge and taking into consideration that some components previously received approval at the general shareholders’ meeting with little margin, will Boards re-evaluate various components of executive compensation packages such as complementary pension schemes, severance payments and non-compete clauses?
- Will companies continue to value stock options and performance shares awarded to corporate officers without applying any “off-market” discount, thus possibly posting overvalued packages?
- What level of dissent at the general meeting is necessary for Boards to review their decisions? Is it really the 50% threshold mentioned in the Code that will trigger a statement from the Board? Also, will special attention be given to approval rates of minority shareholders, particularly in controlled companies?

Responsibilities related to the General Shareholders' Meeting and to the Board of Directors

Our global knowledge suggests that SOP resolutions are subject to minimal rejections and therefore lack a direct effect on the level of remuneration. The main impact is governance related with a negative media image.

The SOP resolution increases the responsibility of the General Meeting and the Board:

- Institutional investors have a fiduciary obligation to their depositors and must prove they limit their portfolio risks and demonstrate themselves as responsible shareholders. Through a specific voting policy on these issues investors will ensure that executive compensation is aligned with long-term shareholder value of the company and that the Board considers its oversight role appropriately. To assess the quality of this control, they cannot simply follow the voting recommendations of proxy advisors with a dogmatic approach - investors must engage in a constructive dialogue directly with issuers. This requires an additional level of preparation and responsiveness on the part of the Board.
- Governance operates based on a double delegation: the general meeting elects the board, which then has responsibility to appoint corporate officers, assess their performance and set their remuneration. The SOP policy represents a real thermometer for shareholders of how governance is functioning, and beyond the amounts allocated, they demand transparency regarding the decision-making process.
- This increased responsibility of the Board raises the issue of control of the process for determining executive compensation in order to meet these new challenges.

Experience abroad shows that investors consider the Compensation Committee to bear the ultimate responsibility for compensation structures. The renewal of Committee members is likely to be challenged at the General Meeting if remuneration practices are regularly deemed inappropriate.
In France, will the Compensation Committee assume the role of conductor and coordinator of various internal operational stakeholders (Board Secretary, HR Senior Management, Legal Senior Management, Financial Senior Management, etc.) or will it limit itself to exerting influence?

Going forward, it is clear that the dispersion of capital of French listed companies, the weight of foreign investors and, consequently, the influence of proxy advisors are distinct elements that require a targeted engagement with the investor community.

Sincerely,

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About Essere Associés

- Essere associés is a company created almost ten years ago, possessing expertise in all aspects of governance and executive compensation (management, finance, tax, social, legal, actuarial, etc.) at national and international levels;
- A multidisciplinary team based in France which brings together a large number of experienced practitioners, with a competitive edge in regard to big English-speaking traditional consultancies;
- In-depth understanding of businesses (business activities, organisation, functioning, values, issues);
- A tailored approach focusing on the business priorities of companies; a creative company that is geared towards the implementation of business solutions;
- Ability to mobilise and unite around the client's project a variety of service providers with specific expertise (firms performing compensation surveys, actuaries, tax attorneys, financial institutions, communication agencies, etc.);
- A contributor to the debate on governance in France, notably by having an active presence at IFA and regular contacts with associations of issuers, investors and proxy advisory agencies.

About Sodali

- Sodali is an independent consulting firm founded in 2006 by European and American experts on governance and shareholder issues.
- The company has seven offices in major European financial centres, in addition to being present in New York and having representatives in Tokyo and São Paulo.
- Its activities focus on strategic events related to the corporate life of companies where shareholders are asked to take a position (voting, contribution of shares, etc.) or where a corporation performs an overhaul or engages in a reflection of its corporate governance practices.
- Sodali is widely recognised for its expertise in the preparation of General Meetings and for its grasp of governance issues resulting from its understanding of the behaviour of French and foreign institutional investors.
- Sodali's goal is to provide clients with information, analysis and services designed to maintain or enhance the relationship between a company and its shareholders, and to assess – or maximize – their membership.
- Sodali's mission is to support companies and to assist them in anticipating, understanding and responding to the expectations and reactions of shareholders and other stakeholders.