Summary of the 2015 shareholder meetings season in France

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The 2015 season of shareholder meetings was more animated than in previous years, and corporate governance practices of French companies was also challenged.

Florange Act - epilogue

The key issue in this proxy season was the fallout from the Florange Act.

Automatic double voting rights in companies that did not previously apply this rule, unless companies offer to opt-out and shareholders vote otherwise, **generated a lot of media coverage**. This breach of common law principles gave rise to exciting moments clearly topped by the French government exercising options held via the APE (French government investments agency) in order to weight at the Renault AGM (and presumably at later meetings), acting like an activist shareholder.

Nevertheless, this saga will not be repeated next year as double voting rights will by then have been established, the **Florange Act will have led to seven French CAC 40 companies joining the 22 that already allowed double voting rights**… 21 after Legrand took the unusual step, with the support of its employee shareholders, to cancel double voting rights.

The double voting rights procedure will certainly continue to have its critics and its adverse effects will crop up from time to time (e.g. creeping takeover, insufficient attention paid to requests from minority shareholders, etc.), however for many boards of directors it is still considered as the most advantageous option for rewarding long-term shareholders. Hopefully French companies will remain just as popular with institutional investors who do not necessarily see this as an advantage.

Executive pay: Is there anyone at the helm?

This was once again the season's hot topic; it is hard to believe that shareholders would prefer to spend less time on it.

Year II of Say on Pay surprised a few boards and compensation committees with **occasional sharp falls in scores** - no outright rejections, but within the SBF 120 (French index of top 120 Paris-listed stocks) almost **a quarter of resolutions were passed with less than 80% approval** (vs. less than 10% in 2014).

So what happened, given that CAC 40 corporate earnings rose 37%, as Ricol-Lasteyrie pointed out (also boosted by capital gains on asset sales)?

Well, shareholders weren't complaining about poor results, excessive executive pay, or even directly targeting any specific executive - **they merely wanted to send a signal to boards of directors or supervisory boards**, because a **lack of transparency and convincing explanations about pay were the main reasons for voting against the resolutions on compensation.**

This is hard to believe, especially when we know how careful companies are when writing executive pay chapters and considering the number of pages in annual reports dedicated to executive pay. Yet according to many shareholders, **the information reported misses its target**: often too complex, it doesn't explain the link between pay and performance, doesn't show the reasoning behind board decisions (in particular for increases in pay) and finally does not reassure them that boards exercise strict control over management. Experience shows that **these issues should be easily overcome**, provided a company has no specific problems, as it happens in countries where the Say on Pay vote has been in place longer than in France (e.g. UK, USA, etc.). This is perhaps the calm before the storm, before a new flood of regulations arrives on the back of the European Shareholder Rights Directive expected in… 2017 (?).

Performance levels used for objectives were especially criticized on current or expired long-term incentive schemes, notably on performance shares (formerly and sometimes still called "free shares"). This issue could be considerable during 2016 in view of the Macron Act, whose benefits to beneficiaries and companies are reserved for plans approved after the Act was introduced.

We observe a number of rejections and much apprehension concerning these items, which require a qualified majority. So what’s the problem? It is that these measures sometimes inflate executive pay considerably, **and shareholders would like to be given the key details** (i.e. criteria applied, the portion paid to corporate officers), **in order to ensure that it is indeed long-term performance that is being rewarded** (three continuous years' evaluation will soon be market practice) **and so that they can understand how challenging the objectives were in reality** (breakdown of payout levels, minimum threshold for payout, etc.). Failing to disclose future targets (which could be of great interest for competitors), shareholders often analyze prior years to get some idea of the suitability of current plans. And it is not always easy to assess long after if payouts have been too generous, or to remember the situation at the time when the Board made its decision; **it is therefore up to the Board to explain how their plans relate to enhancing long-term value.**

Shareholders have at last begun **to criticize benefits granted to executives** (e.g. severance pay / non-compete compensation, pensions), with nearly **2/3 of resolutions submitted voted through with under 70% in favor** within CAC 40 companies. The reasons for opposition are mixed and varied: triggering events for payout judged too flexible, performance conditions insufficiently demanding, too many benefits, etc. The Macron Act will spark another debate about "golden parachute" compensation, which must henceforth be linked to conditions of performance, notably when reappointing the beneficiary as director. Nevertheless, it is perhaps more the media and political pressure limiting the sums involved and the conditions giving rise to the payments. In the end, it's up to boards and shareholders alike to review the situation, so that they avoid challenging properly awarded packages that would undermine the reputations of those concerned, but which would ultimately damage the reputations of the Boards themselves even more.

To sum up, thanks to better reporting, the bottom line is that **shareholders** – who are naturally suspicious – **want to be in a position to judge whether their boards are indeed fulfilling their responsibility of oversight and control, and early rather than later**. Rather than micro-managing the companies in which they invest and deciding on levels of pay themselves, **shareholders want in reality to judge the responsiveness of their Boards, as well as their ability to question, evaluate and encourage management.**

In the United States, where senior management fear for their jobs after a series of quarters of poor results, the SEC similarly insists on reporting a pay for performance summary. It's board members who now pay the price for being too kind-hearted with their management, with lost votes of confidence and activist shareholders getting involved by demanding they be revoked first.

Aside from shareholder meetings, what about board performance?

So it appears pay could be a way of judging good board performance, and shareholders will say they're working from factual data. However, what they really wish to better understand is the Board dynamic, and what influence boards really have over setting and rolling out the strategy.

While shareholders are increasingly consulted in France (e.g. Say on Pay, vote on sales of significant assets, etc.), their real power continues to lie in appointing, renewing and dismissing directors. This power is undoubtedly underestimated.

The real question remains as to how responsible boards, which are granted powers by shareholders, **really are**: selecting senior management, setting strategies, preparing succession plans, reviewing strategies and long-term value creation for stakeholders. Shareholders tend to gauge the competence of their boards during a crisis; in other words, too late. That's why **those who invest for the long term are pushing more and more for constructive engagement with non-executive board members**, to get some assurance and a better idea of the risks. They also seek regular and thorough evaluations of boards to go over more subjective issues, for which Proxy Advisors do not have the required distance or means of assessment.

So, 2015 **French corporate governance was questioned more than ever, and it often demonstrated that it works**: BNP Paribas is back on track after a record fine, Total has overcome the sudden death of its CEO/Chairman, while Sanofi, accepting the risk of surprising the market, preferred to completely overhaul a defective corporate governance system for the long-term benefit of its stakeholders (which did not please all commentators); lastly, other top managers have been replaced without apparent damage. **All this goes to show that French boards do not lack competent directors.** It is all the more regrettable that shareholders or public opinion must take offence, essentially about pay, before proper answers are sometimes provided.

The upcoming replacement of many top executives, and how boards of under-performing companies react, will offer excellent opportunities for evaluating the competence and independence of directors, and for reassuring the investment community.

There is still hope; Bank of England chief economist Andy Haldane recently praised the French system, underlining that short-term shareholders had less influence on management decisions. He also stated that if shareholders want to spend less time talking about pay, they should start by paying more attention to Board’s effectiveness.

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