

AMF recommendation 2012-02

Corporate governance and executive compensation in companies referring to the AFEF/MEDEF code – Consolidated presentation of the recommendations contained in the AMF annual reports

Background regulations: 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

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Pursuant to Article L. 621-18-3 of the Monetary and Financial Code, The *Autorité des Marchés Financiers* (AMF) draws up a report on corporate governance and executive compensation each year, on the basis of the information disclosed by the legal persons the securities of which are admitted to trading on a regulated market and with their registered office in France. For this purpose, the AMF “may approve any recommendation it may consider relevant” and its report aims to review the best practices of listed companies in this field and to promote them through recommendations and areas for discussion.

In the context of this report, the AMF ensures the transparency of the information disclosed by listed companies on corporate governance and executive compensation. Moreover, the AMF reviews particularly the way in which companies implement the recommendations laid out in the corporate governance code jointly issued by the AFEP and the MEDEF (hereinafter referred to as the “AFEP/MEDEF code”).

The AMF calls on issuers to apply the recommendations laid out in the annual reports on corporate governance, executive compensation and internal control and in its recommendation of 22 December 2008 pertaining to information on executive compensation to be disclosed in registration documents.

It is also recalled that companies must implement the “comply or explain” principle presented below.

In order to make it easier for issuers to apply these recommendations, this document compiles the recommendations relating to the companies referring to the AFEP/MEDEF code, and includes, after removal of potential duplicates, the recommendations issued by the AMF since 2009 and contained in the following documents:

- The 2010 and 2011 reports on corporate governance and executive compensation (AMF recommendation 2011-17)
- The report of 8 December 2009 on corporate governance and internal control
- The report of 9 July 2009 on executive compensation in listed companies and on the implementation of the AFEP/MEDEF recommendations.

However, this document does not include the recommendations:

- addressed to companies which do not refer to any code,
- on internal control¹,
- which, de facto, were already covered by the “comply or explain” principle.

Beside, some recommendations have been included in the list of issues to be addressed identified by the AMF, reiterated hereinafter for the record, in the aforementioned reports on corporate governance and executive compensation.

This document also recalls, for the record, the “issues to be addressed” identified by the AMF in the aforementioned reports on corporate governance and executive compensation.

As regards more particularly audit committees and internal control, the AMF refers readers to its recommendation 2010-19 on audit committees, to which reference is made in the paragraphs below, as well as its recommendation of the same day on risk management and internal control systems (A guide to applying the reference framework for midcaps and smallcaps).

¹ For this purpose, it bears recalling the AMF position - recommendation 2010-16 on the reference framework for risk management and internal control systems.

I. Implementing the “comply or explain” principle

1. The reference or lack of reference to a corporate governance code

The AMF recommends that companies which have chosen to refer to a corporate governance code:

- indicate clearly the corporate governance code they chose to use;
- use the words written in the French Commercial Code, in particular “refer to” or, as appropriate, other words such as “apply” or “be compliant with” which are not misleading. The AMF considers that the wording “makes every effort to comply with” shall be avoided. When companies indicate that they are in the process of becoming compliant, the AMF recommends that they provide a detailed explanation of the steps planned to achieve compliance.

2. Implementing the “comply or explain” principle

In order for companies to be able to implement the “comply or explain” principle, the AMF recommends that they disclose in an accurate manner in their registration document or annual report any information pertaining to the implementation of the recommendations laid out in the corporate governance code to which they refer.

When a recommendation of the code is being ruled out, the AMF recommends that companies provide explanations that are sufficiently detailed and adapted to their particular circumstances.

II. Corporate governance recommendations and related issues to be addressed

1. Recommendations for corporate governance

1.1 The organisation of the board’s work

The AMF recommends:

- that companies which have changed their corporate governance structure and practices document these changes and the reasons behind them in a clear and detailed manner, and indicate the measures taken to avoid potential conflicts of interest that may arise out of these changes;
- that companies which have separated the roles of chairman of the board of directors and chief executive officer should describe the chairman's duties in detail;
- as appropriate, that companies indicate the specific measures taken to ensure a balance of powers within the board or directors when merging the positions of chairman and chief executive officer;
- that companies which have introduced a lead director should describe in detail his role and duties, as well as the resources available to him/her and his/her prerogatives.

1.2 Independent board members and management of conflicts of interest

As regards the management of conflicts of interest, the AMF recommends that companies which refer to the AFEP/MEDEF code, which expressly provides for reporting and managing conflicts of interest involving members of the board of directors or supervisory board, provide information on the management of these conflicts of interest.

As regards the independence of board members, the AMF recommends that companies:

- identify clearly the members who have been classified as independent by the board, regardless of whether these directors are members of specialised committees,

- carefully specify that they are compliant with the director independence criteria set forth in the AFEP/MEDEF code and, when failing to comply with one of these criteria, explain in detail as to why,
- explain in detail each year how the board of directors or supervisory board assessed the materiality or non-materiality of the business relationships likely to be entered into by independent members with the company in which they serve as executive directors or supervisory board members. In this context, and as appropriate, the AMF recommends that companies describe in detail the contents of any binding commitment on these board members so as to ensure that the requirements for an independent director are preserved, as well as the potential implications of breaching these commitments.

As regards boardroom diversity, the AMF recommends:

- that companies looking to achieve boardroom diversity, in terms of female board members, nationality or international experience, mention this objective when building on the issues to be addressed for assessing the board's work;
- that companies which do not give any information on the nationality or international experience of their directors adopt such a policy.

Lastly, the AMF recommends that all companies:

- provide details of the tasks and work carried out by the board;
- give a complete overview of the board's activity;
- disclose the directors' attendance rate at board meetings.

1.3 The board's rules of procedure

The AMF recommends that the rules of procedure be reviewed on a regular basis and, as appropriate, be completed or amended in order to comply with the applicable regulations.

1.4 The board's specialised committees and the audit committee

The AMF recommends that companies describe properly the functioning and tasks falling to the committees, and give an overview of their work by detailing the interactions between these committees and the board.

The audit committee or accounts committee

As regards companies which have set up an audit committee or accounts committee, the AMF recommends that their members and chairman be all clearly identified. It also recommends that the paragraph introducing the members of the audit committee describes their expertise. As per the composition, the functioning and the tasks falling to the audit committee, the AMF refers to the conclusions of the working group on audit committees of July 2010 and to the AMF recommendation 2010-19 on audit committees.

The AMF also recommends that companies improve the information on how the executive chairman, as appropriate, may participate in board meetings when the board meets as the audit committee. It recalls that the working group on audit committees recommended that the chairman, when he is an executive board member, refrain from attending these meetings². Moreover, since there is not chairman for such meetings, it encourages boards meeting as the audit committee to choose the person designated as competent and independent within the meaning of Article L 823-19 of the French Commercial Code to chair the meeting.

² However, the executive chairman may be invited to attend part of the meeting.

1.5 Assessing the board's work and that of its committees

Under the AFEP/MEDEF code, companies are required to devote an item of the board's agenda to a debate on its operating methods and to perform a formal evaluation at least once every three years. The AMF encourages companies to conduct, as far as possible, an evaluation of the board's mode of operation and recommends that they provide details of how that assessment had been conducted, and, in particular, whether an outside consultant had been involved. The AMF also urges companies to disclose the results of that evaluation, and, more specifically, any potential areas for improvement that may have been identified.

The AMF calls on companies to include, when they disclose information about the results of board evaluations as well as the desirable changes discussed as part of these assessments, the contents of discussions held during the evaluation on the issue of greater boardroom diversity.

1.6 Information on multiple directorships

The AMF recommends that companies specify whether the directorships in question are held outside the group or not and whether the companies in which they are held are listed or not.

The AMF reminds companies that particular attention should be paid to complying with the AFEP/MEDEF recommendation on multiple directorships or explaining non-compliance.

1.7 Restrictions on the powers of the chief executive officer

The AMF recommends that all restrictions on the powers of the chief executive, and those of his deputies as the case may be, should be disclosed. If these restrictions have been adopted officially, companies should provide a cross-reference to the rules of procedure. If no restrictions have been applied, the AMF recommends that companies state this explicitly.

1.8 Presentation and preparation of the chairman's report on corporate governance

The AMF recommends that companies describe the due diligence done when preparing the report and the list of units, departments and bodies concerned. For the sake of clarity, this description should preferably be presented in the introduction to the report.

The AMF encourages companies to go beyond merely listing due diligence activities and urges them to provide a clear and detailed summary of the work carried out in this regard.

The AMF stresses the need for clarity in the presentation of the report on corporate governance and internal control. It recommends that, when the contents of the report are spread out over several sections of the registration document, the report should refer readers to these sections. Companies that publish their registration document in the form of an annual report should supplement the cross-reference table with such references.

2. Issues on corporate governance to be addressed

In theory, these issues to be addressed are not intended for issuers. They are aimed at the industry groups which draw up corporate governance codes. The AMF suggests that these groups take these guidelines into account when discussing these issues. However, issuers may also adopt these guidelines on a voluntary basis as best practices.

2.1 The independence of board members

Given the report's observation that there are many different interpretations of what is meant by the independence and financial/accounting expertise of directors (concepts that are referred to in the regulations), discussions could be held on:

- clarifying the concepts of independence and financial and accounting expertise and the executive compensation arrangements,
- the right balance between independence and competence through the appointment of directors with an appropriate professional activity.

2.2 Boardroom diversity

Discussions about boardroom diversity could be initiated. Indeed, aside from the need for board members to have specific individual qualities, such as independence, competence and experience, greater diversity, with more women, foreign directors, and so on, might well help improve the quality of work done by boards.

2.3 The stability of corporate governance structures in listed companies

Discussions could be held about corporate governance and on its definition, in particular where a company chooses to revert to a structure that it recently abandoned.

2.4 The board's rules of procedure

In order to ensure the orderly functioning of the board and transparency of its work and that of its specialised committees, it is proposed that listed companies make certain sections of the board's rules of procedure available for consultation, on their website for instance.

2.5 The lead director

The appointment of a lead director is an interesting area for discussion which aims to prevent potential conflicts of interest, in particular should the positions of chairman and CEO be combined. In this respect, it is important that companies which decided to appoint a lead director give him the powers and resources needed to perform his/her duties, in particular that of convening a board meeting and it is essential that these powers and resources be formalised and transparent. Besides, companies which appointed a lead director could address the issue of his/her activity in terms of corporate governance on the occasion of the board assessment and/or in the chairman's report on corporate governance.

In addition, it is necessary that the lead director be independent and that the company takes stock of his/her actions in order to assess on the one hand the nature of the due diligence and tasks performed as a lead director and, on the other hand, how he may have used the powers given to him.

2.6 Multiple directorships

The issue of reinforcing the AFEP/MEDEF recommendation on multiple directorships should be addressed. In this context, akin to what might have been planned in practice, it may be envisaged that acceptance of corporate office (chairman and chief executive officer, chief executive officer, vice chief executive officer, chairman of the management board, manager of corporate partnership) by an executive director be subject to the prior agreement of the board. Lastly, as regards the non-executive board chairman and the tasks that may be entrusted to him/her by the board of directors, it may be envisaged that the latter make specific recommendations in this regard.

2.7 The status and the role of the non-executive chairman in companies with a board of directors

Addressing the corporate governance issue implies giving consideration to the status and the role of the chairman in companies with a board of directors. This requires in particular assessing (i) the nature of the tasks assigned to the non-executive chairman of the board, (ii) the body that entrusted the non-executive chairman of the board with these tasks and the procedure followed as appropriate (opinion of a committee for instance), (iii) the limits to these duties, in particular as regards the powers of the chief executive officer and (iv) the way in which performing these tasks is taken into account by the board when determining the different components of compensation.

2.8 The board committees and their chairpersons

On the issue of composition of committees and in particular the composition of the audit committee, the AMF urged companies to appoint independent directors to chair such committees and to increase the proportion of independent directors on these committees generally. The AMF also encouraged companies to avoid, as far as possible, having executive directors as members, much less chairmen, of such committees.

2.9 Evaluation of the board's work

The AMF recalls that, pursuant to the AFEP/MEDEF code, the evaluation aims in particular to “measure the effective contribution of each director to the board's work based on their skills and effective input.” With regard to the findings of applying this recommendation, it may be useful to specify what is expected from companies in practice when addressing this issue.

2.10 Restrictions on the powers of the chief executive officer

The AMF encourages companies to place restrictions on the powers of the chief executive officer, regardless of whether he is also the chairman of the board or not, as well as on the powers of its representatives. It encourages companies to introduce restrictions if there are none, to maintain and strengthen existing restrictions, and to make restrictions transparent by publishing them in the rules of procedure.

III. Recommendations for executive compensation and related issues to be addressed

1. Recommendations on the presentation of the information on executive compensation

1.1 Presentation of the information on executive compensation

The AMF remind listed companies that it encourages them to disclose in their registration document all the information relating to executive compensation according to the terms specified in the AMF position-recommendation 2009-16 – A guide to preparing registration documents.

When the listed company belongs to a group, the AMF recommends in particular that information on executive compensation deals with the sums collected under the directorship held within the listed company, by all the companies in the chain of holdings and those on which the parent company has a significant influence.

The AMF recommends that companies present a summary of the exceptions to the AFEP/MEDEF code and the reasons behind them.

1.2 Stock options and performance shares

The AMF recommends³ that:

- the AMF recommends that the exercise of all stock options granted to executives and the final allotment of all performance shares should be subject to both internal and, where possible and appropriate, external performance criteria. The beneficiary's continued presence within the company when options are exercised and performance shares are finally allotted cannot be considered a serious and demanding performance criterion;
- the company stipulates that, to the best of its knowledge, it does not have any hedging instruments;
- the information relating to the obligation to hold shares for a mandatory period, provided for in Articles L. 225-185 and L. 225-197-1 of the French Commercial Code and specified by the AFEP/MEDEF code, be presented in the registration document. The obligation to hold shares granted for free or resulting from the exercise of stock options should be sufficiently binding so as to allow better recognition of the company's performance in the long term.

1.3 The variable components of remuneration

The AMF recommends that companies:

- precisely define the qualitative criteria for determining the variable components of remuneration of directors, except in special cases where the company stipulates, at least, that some qualitative criteria have been predetermined and precisely defined, though not published for confidentiality reasons.
- specify the expected level of achievement of preset quantitative targets assigned to executive directors for them to be able to receive variable compensation or indicate, at least, that the level of achievement of these qualitative targets has been established in an accurate manner, though not published for confidentiality reasons, provided that the nature of these qualitative targets is documented.

1.4 Severance pay

The AMF recommends that companies:

- give a detailed description of the provisions relating to severance pay for each executive director in the registration document and specify the arrangements for paying such benefits;
- mention explicitly that the payment of severance pay only takes place in the event of forced departures related to a change of strategy. Accordingly, severance pay should not be paid where a director leaves the company of his/her own volition, moves to a new position within the group or where he/she has the possibility to exercise his/her rights to retirement in the short term.

1.5 Supplementary pensions schemes

The AMF recommends that companies:

- mention in their registration document that overall executive compensation was determined, where appropriate, based on the benefits of having a supplementary pension scheme;
- publish exhaustive information on the individual pension rights exercised, which includes the arrangements for determining and calculating the retirement benefits of each beneficiary (working period and amount of reference salary, annual potential pension rights as a percentage of the reference salary, accrued potential pension rights at the end of the period, cap on potential pension rights, corporate seniority and attendance requirements).

³ AMF 2010 report on corporate governance and executive compensation – 12 July 2010.

2. Executive compensation-related issues to be addressed

The AMF wishes to recall its areas for discussion on the following issues:

2.1 Assessment of qualitative criteria

The AFEP/MEDEF code contains several qualitative criteria hardly assessable in practice, i.e. the “demanding” nature of the performance criteria governing the granting of severance pay, the fact that the number of beneficiaries qualifying for the supplementary pension scheme is considerably higher than the number of executive directors, the fact that potential pension rights must account for a “limited” percentage of compensation only and that options and bonus shares must not account for a “disproportionate” percentage of total compensation. The question arises as to the need to define more accurately these criteria and to ensure that they are all properly implemented. This area for discussion does not intend to call into question the use of qualitative criteria for determining the variable compensation insofar as these criteria are absolutely legitimate.

2.2 The ban on using hedging instruments

The AMF recommends that executive directors make a firm commitment not to hedge their options and that such commitment be inserted in the registration document.

2.3 The concurrent holding of an employment contract and corporate office in listed subsidiaries

The AMF proposes that, as regards listed subsidiaries of listed holding companies, the AFEP/MEDEF code be amended on an ad hoc basis. It seems appropriate that the managing director of the listed subsidiary be subject to the code and that the issuer explains, where appropriate, the reasons behind its decision to maintain the employment contract of its director with the parent company according to the “comply or explain” principle. In this case, it seems appropriate that the director holding an employment contract be not granted termination payments.

2.4 Compensation arrangements for non-executive chairmen

The AMF calls for addressing the issue of compensation arrangements for non-executive chairmen, taking into account the diversity of personal circumstances and functions exercised by these board members as well as their regulatory and supervisory responsibilities within the company

2.5 The incorporation of the European Commission’s recommendation

The European Commission published on 30 April 2009 a recommendation on the regime for the remuneration of directors of listed companies which extends the scope of two previous recommendations. Although the applicable French legal requirements for the remuneration of directors and the AFEP/MEDEF code are in line with the European Commission’s recommendations, the latter contains elements that may be given consideration and, as appropriate, included in the Code: the fact that the company’s long-term viability should be included in the set of performance criteria, the deferred payment of the variable components of remuneration, or the exclusion of the variable components of remuneration when calculating severance pay.

In its recommendation, the Commission deals with the respective roles of the board of directors, supervisory board and shareholders in terms with regard to corporate governance. The AMF suggests that industry associations take into account these guidelines when discussing the issue of remuneration policies.