

AMF recommendation 2010-15

AMF supplementary report on corporate governance, executive compensation and internal control – Mid-caps and small-caps governed by the Middlenext corporate governance code of December 2009.

Background legislation: Articles L.225-37, L.225-68, L225-102-1, L.225-185, L. 225- 197-1, L. 823-19 and L.823-20 of the French Commercial Code

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Summary

This report has prepared in accordance with Article L. 621-18-3 of the Monetary and Financial Code which tasks the *Autorité des Marchés Financiers* (AMF) to draw up a report based on information on corporate governance and internal control published by the legal persons having their registered office in France and whose securities have been admitted to trading on a regulated market.

This report supplements the AMF 2010 report on corporate governance and executive compensation published on 12 July 2010.

This report was drawn up on the basis of the analysis of the information published by a sample of thirty companies the securities of which have been admitted to trading on Euronext Paris (seven companies listed on the compartment B and twenty-three companies listed on the compartment C) which use the corporate governance code for small and medium listed companies (VaMPs)¹ published by Middenext in December 2009. Out of these companies, twenty-seven use the AFEP-MEDEF corporate governance code for listed companies and three, by contrast, do not refer to any code.

The first part of the report deals with methodology used and a review of prevailing standards (I). The AMF then present the findings of its analysis of the corporate reports on corporate governance (II), internal control (III) and executive compensation (IV). Based on these findings, the report proposes recommendations aimed at improving the quality of the information provided and, as appropriate, at identifying issues to be addressed.

The major features of the report are the following:

The findings of this report arise from a study conducted on the basis of a sample of companies which apply recommendations set forth in a corporate governance code. Accordingly, the results shown hereinafter must be construed in light of this sample and cannot possibly be considered as fully representative of all practices applicable to small and medium listed companies, including some which are not included in this sample and, in some particular cases, need to drastically improve their structure in terms of corporate governance, executive compensation and transparency of information.

1. Corporate governance

1.1 Findings

The findings that arise from the first application of the recommendations provided for in the Middenext Code of December 2009 show promising results both in terms of practice and information provided to the market. The implementation of a framework specifically tailored to small and medium listed companies may have contributed to change the way in which these companies understand corporate governance practices, thanks to the recommendations set forth in the Code:

¹ Small- and mid-caps are listed companies whose market capitalisation is below or equal to one billion euros, pursuant to the AMF position on the definition of the small- and mid-caps (Mansion report). This threshold meets, in practice, the criteria set out by NYSE Euronext as regards the companies listed on the compartments B and C of Euronext.

Reference to a corporate governance code:

- companies which did not apply any code last year - i.e. 10% of the companies comprising the sample - now refer to a corporate governance framework.
- of all the companies which adopted the Middenext corporate governance code, 63% explained the reasons for such a decision.
- 97% of the companies use clear and precise terminology when referring to the Middenext Code.
- beyond applying the recommendations provided for in the Middenext Code, 67% of the companies indicate that the board of directors has learnt about the information disclosed under the heading ‘Points to be watched’ of the Middenext Code.

The proportion of independent board members and the definition of criteria for assessing independence:

- 80% of the companies comprising the sample have at least one independent board member.
- 89% of those companies with a board of directors made up of more than 5 directors have at least two independent directors, thereby complying with the recommendation of the Middenext Code on the issue. By contrast, only 50% of those companies with a board of directors made up of five directors or less have one independent board member.
- 92% of the companies define the concept of independence and, out of those, 54% present detailed criteria on the basis of which the board of directors assess independence.
- the explanations given by some companies to explain the reasons why they don’t comply with the recommendation of the Middenext Code on the proportion of independent board members (i.e. the “comply or explain” principle) can be further improved. Under certain circumstances, the application of independence criteria raises questions.

Activity of the board of directors:

- all the companies comprising the sample indicated the number of annual meetings held by their board of directors, which averages at more than six.
- 83% of the companies indicated the average directors’ attendance rate, which stands at 88%.
- moreover, 77% of the companies comprising the sample provided information on the review the board’s work.

Rules of procedure of the board of directors:

- 60% of the companies comprising the sample mention the existence of rules of procedure and 72% give details on their content.
- the arguments put forward by some companies not to implement rules of procedure (i.e. the “comply or explain” principle) can be further improved.

The audit committee and other board committees:

- 43% of the companies have set up an audit committee as a whole.
- 37% of the companies have decided to entrust their board of directors with the duties that usually fall to the audit committee.
- where an audit committee is established, 85% of the companies describe its duties and 77% took stock of its activity. In 58% of the cases, the committee is chaired by an independent director.
- moreover, 40% of the companies comprising the sample have set up a compensation committee. The compensation committee also acts as an appointments committee in about half the cases.

Assessment of the board of directors’ work:

- 40% of the companies stated they conducted an assessment of the board’s work in 2009 and 20% plan to do the same in 2010.
- 23% of the companies provided no information on the assessment of the board’s work.

1.2 Recommendations and issues to be addressed

➤ **Recommendations**

In the first place and generally, the AMF noted that some companies of the sample use their size, the size of their board of directors or the presence of an important majority shareholder as a reason for not applying some of the provisions laid down in the Middlednext Code.

The AMF considers that such reasons can hardly be taken into consideration under the “comply or explain” principle insofar as the Middlednext Code is tailored, by definition, to companies with such features.

The findings arising from this report have prompted the AMF to issue the following recommendations, which are intended to listed companies and aim to improve the information they provide in regards to the application of their reference corporate governance code:

1. Reference to points to be watched

- Some companies did not expressly indicate in the report that their board of directors had been informed of the points to be watched and failed to give any explanation as to why. Given the importance of this scheme within the Middlednext framework, the AMF recommends that companies apply the recommendation of the Middlednext Code and calls on companies, where appropriate, to explain in details why the board of directors has not been informed of the points to be watched.

2. The proportion of independent board members and the definition of criteria for assessing independence

- The AMF recommends that companies apply the Middlednext Code Recommendation relating to the number of independent board members. Failing this, companies should explain in details why they did not comply with this recommendation, leaving aside factors such as the size of the company, the size of the board of directors or the size of the shareholding structure - which are already taken into account in the Middlednext Code - so as to meet the requirements of the “comply or explain” principle set forth in the law.
- The AMF recommends that companies provide details on the independence criteria that were set aside and those they chose to endorse. The AMF calls on companies to explain how they apply those criteria.

3. Rules of procedure of the board of directors

- The Middlednext Code recalls that companies shall indicate as clearly as possible the duties that fall to the directors in the rules of procedure of the board of directors, which lay down the rules according to the company’s particular circumstances. In this context, and in order to comply with the requirements of the “comply or explain” principle laid down in the law, the AMF recommends that companies which did not introduce rules of procedure explain in detail why they failed to do so.

4. The audit committee

The AMF recommends that companies indicate whether or not they set up an audit committee as a whole and, where appropriate, urges them to refer expressly to Article L.823-20 4° of the Commercial Code, should they decide to entrust their board (board of directors or supervisory board) with the duties that usually fall to the audit committee. The AMF moreover recalls that the audit committee can only be made up of board members. It also recommends that companies which chose to entrust their board with the duties that usually fall to the audit committee describe in details the operating rules of the board when it meets as the audit committee.

In this respect, it bears recalling that the AMF working group on audit committees, whose report gave rise to the AMF recommendation 2010-19, recommended that where the chairman of the board is an executive director, he should refrain from attending any meeting where the board meets as the audit committee².

- Pursuant to its recommendation 2010-19 on audit committees, *“the AMF recommends that all companies whose securities are admitted to trading on a regulated market refer to the working group’s report on audit committees. The companies are asked to specify in the chairman’s report on internal control and risk management procedures whether or not they made use of the working group’s report. Where it is applied partially, the companies should clearly identify the recommendations that were applied.”*

5. Reviewing the board’s work and that of its committees

- The Middenext Code recommends that the board of directors conduct a self-assessment of its work on a yearly basis. In order to meet the requirements of the “comply or explain” approach laid down in the law, the AMF recommends that companies which do not comply with this recommendation explain in details the reasons as to why not.

➤ **Issues to be addressed**

The findings that arise from this report prompted the AMF to propose the following issued to be addressed to Middenext and suggest that these guidelines be taken into account as part of its deliberations on the issue:

1. Points to be watched

The points to be watched mentioned in the Middenext Code recall the main issues to be tackled by the board in order to ensure effective corporate governance. The Middenext Code requires that companies indicate in the chairman’s report that the board has been informed of the information disclosed under the heading “points to be watched”.

In addition to the obligation to indicate that the board has been informed of the content of the points to be watched, the companies may also be encouraged to give the board’s opinion on the points to be watched in general terms.

2. Assessing the board’s work

The Middenext Code recommends that, once a year, the board’s chairman invite directors to give their opinion on the way in which the board operates and on the preparation of its work. This discussion shall be recorded in the minutes of the meeting. However, pursuant to this recommendation, it is not required that the outcome of this assessment be communicated to the shareholders. Still, the main findings of this self-evaluation, in particular the potential areas for improvement, may be mentioned in the chairman’s report on corporate governance and internal control.

2. Executive compensation

The findings that arise from the first application of the recommendations laid down in the Middenext Code show promising results for small and medium listed companies, both in terms of practice and information provided to the market.

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

2.1 Findings

The concurrent holding of an employment contract and corporate office

- Nine companies out of the thirty comprising the sample (30%) indicate that their executive directors concurrently hold an employment contract and corporate office. Twenty companies indicate that their executive directors do not have an employment contract. One company does not provide any information on the issue.
- Out of these nine companies, the AMF reviewed more specifically the particular circumstances of five companies which renewed the terms of office of their executive directors with an employment contract in 2009 and early 2010. These five companies have maintained the employment contract of their directors:
 - Two companies argue that the length of service of their directors as group employees accounted for their decision to maintain their employment contract.
 - One company fails to provide careful justification as regards its decision to maintain the employment contract of one of its directors. Moreover, two other companies indicate that their executive directors have an employment contract with another company of the group. These three companies accurately describe the personal circumstances of the directors concerned in their registration document but fail to provide any reason for maintaining their employment contract.

Severance payments

- Companies in the sample rarely provide details on severance payments to executive directors in their registration documents.

Stock-options and distribution of bonus shares

- In 2009, only five companies out of the thirty comprising the sample - i.e. 17% - awarded stock options or bonus shares. Out of these five companies, two specify in their registration document that the exercise of stock options is contingent upon performance criteria and one company indicates that the exercise of stock options is subject to the recipient of the options being present upon maturity of the plan.
- Two companies out of the five that awarded stock options or performance shares in 2009 specify that their directors are required to hold a predetermined number of securities arising from the exercise of the options until directorship expires.

Variable remuneration

- Nineteen companies out of the thirty comprising the sample - i.e. 30% - state that they pay variable compensation to their executive directors.
- Out of these nineteen companies:
 - three provide details on the performance criteria for determining the amount of variable compensation paid to executive directors,
 - eleven companies merely indicate that the payment of variable compensation is contingent upon performance criteria,
 - five companies do not indicate whether performance requirement have been set for payment of variable compensation or not.

2.2 Recommendations

In order to make it easier for companies to implement the Middenext Code, the AMF makes the following recommendations relating to information on executive compensation and to the application of the Code:

1. In order to facilitate access to information and to make it more legible, the AMF recommends that companies:
 - Use table 10 of its recommendation 2009-16 summarising the information on the employment contract, severance and non-competition agreement benefits and on the existence of a defined benefit retirement scheme.
 - Compile all information and tables in the part dedicated to executive compensation in the registration document or, if the company does not wish to duplicate such information, insert explicit cross-references in other parts of the document where such information is disclosed.
2. The AMF recommends that, where appropriate, companies indicate expressly in the registration document the following information:
 - the arrangements for determining and paying severance benefits,
 - the arrangements for determining and paying variable executive compensation, and in particular the criteria for determining variable compensation³, with the exception of special cases in which companies may, as a minimum, indicate that certain specific, predefined qualitative criteria cannot be publicly disclosed for confidentiality reasons.
3. The AMF reminds companies which have not yet complied with such recommendations that the code provides for the exercise of all or part of the stock options or the final allotment of part or all of the bonus shares to their executives to be contingent upon relevant performance criteria which are in the company's medium/long term interest. As such, the AMF considers that the presence of the recipient upon exercise of the options or distribution of the performance shares is not a performance criterion.
4. As regards the concurrent holding of an employment contract and corporate office, the AMF recommends that the issuer provide careful and detailed reasons for upholding the employment contract of its senior managers. The AMF considers that a company provides careful and detailed explanations when its decision to maintain the employment contract of one of its senior managers is based on its length of service as a group employee and on its personal circumstances. Moreover, the AMF recommends that the board's decision to authorise or not an executive director to concurrently hold an employment contract and corporate office applies to employees serving as executive directors in a listed company and with an employment contract with a group company.

3. Internal control and risk management

3.1 Findings

The findings relating to the information provided as regards internal control and risk management procedures are promising:

Using the AMF Reference Framework:

- 50% of the companies in the sample indicate that they use a specific reference framework for internal control. In this context, 87% of companies decided to apply the AMF reference framework exclusively.

³ Pursuant to Article L. 225-102-1 of the Commercial Code.

- In the vast majority of cases, the terminology used to make a connection with the reference framework is clear and precise.
- However, the chairman's report does not necessarily follow the outline of the AMF reference framework.

Internal control objectives and limitations:

- 93% of the companies mention the existence of internal control objectives.
- Of those companies, 96% report that they comply with the applicable laws and regulations and 93% provide information on the reliability of financial information.
- 83% of the companies comprising the sample provide information on the limits of internal control.

Details on the procedures and related parties and information on the risks:

- 97% of the companies provide information on the procedures aimed at guaranteeing the reliability of financial information.
- 93% of the companies provide information on the resources deployed for internal control and risk management, but only 7% presented a detailed organisational chart of the players involved.
- 83% of the companies provide information on the risks they are confronted with in the chairman's report, either by giving details on these risks or by inserting an explicit cross-reference in another part of the registration document or annual report.
- 66% of the companies establish a link between risk assessment and risk management procedures.

Ongoing improvement process and internal control assessment:

- 70% of the companies comprising the sample report they have initiated an ongoing improvement process aimed at improving internal control, although this is not expressly mentioned.
- 10% of the companies indicate that they conducted an evaluation of internal control in 2009 and, amongst those which did not, 6% reported that they were considering doing so in the financial years to come.

3.2 Recommendations

3.2.1 Recommendations arising from the findings of the report

The findings arising from this report have prompted the AMF to make the following recommendations, aimed at listed companies and at improving the information they provide on internal control and risk management procedures:

- for the sake of legibility and comparability of the information disclosed in the reports, the AMF recommends that companies follow the outline of their reference framework.
- the AMF notes that some companies using the AMF reference framework only mention part of the objectives of the framework and fail to mention, in particular, the objective related to the effectiveness of the internal processes intended to safeguard the assets. In order to avoid any ambiguity, and for the sake of coherence, the AMF recommends that companies which use a reference framework recall all the objectives of this framework and, for this purpose, use the exact terminology used in it.
- the AMF recommends that companies make a clear connection between the internal control objectives and the description of the procedures in the chairman's report.
- the AMF recommends that companies indicate whether they conducted an evaluation of internal control or not and, where appropriate, describe its outcome. The AMF also recommends that companies detail areas of improvement for their internal control and risk management procedures.

3.2.2 The AMF Recommendation of 22 July 2010

On 22 July 2010, at the same time as it published its updated reference framework for internal control and risk management, the AMF published a recommendation which notably provides that the reference framework – supplemented by application guidelines - is a tool for analysing and developing corporate internal control and risk management systems, which permits improving the coherence and legibility of the chairmen's reports. In this context, the AMF recommends that all companies the securities of which have been admitted to trading on a regulated market use this reference framework⁴.

As regards more particularly small and medium listed companies, the AMF recommendation provides that these companies: *"(...) are invited to specify, in the chairman's report, whether they use this guide for implementing the reference framework when drafting the chairman's report or not. Similarly, it is recalled that, when preparing their report, the companies concerned must pay particular attention to the pieces of information liable to have a material impact on their assets or results. Consequently, small and medium listed companies are not required to disclose the answers to the questionnaires included in the guide in the chairman's report on internal control and risk management procedures. Should the company decide not to use the reference framework to draft the chairman's report, the same transparency principles shall apply to any other framework it chooses to implement or is required to apply at an international level. In such cases, the framework used shall be clearly presented."*

I. METHODOLOGY AND SUMMARY OF THE CONTENT OF THE APPLICABLE LEGISLATION AND REGULATIONS⁵

1. Purpose of the report and methodology

1.1 Purpose and sample

Purpose

The purpose of this supplementary report is not to determine the portion of small and medium listed companies using a reference corporate governance code or the portion of companies using one of the existing reference corporate governance frameworks (Code AFEP/MEDEF or Code Middenext) and it is not to recommend using a particular framework.

This report supplements the AMF annual report on corporate governance and executive compensation published on 12 July 2010. It aims at taking stock of the best practice applicable to small and medium listed companies governed by the Middenext Code as regards corporate governance, executive compensation and internal control. For this purpose, it is vital that the information disclosed by the issuers be analysed.

1.1.1 Sample

For the purpose of this report, the AMF selected a sample of thirty companies using the corporate governance code for small and medium listed companies published by Middenext in December 2009 as their reference code. This sample includes seven companies listed on the compartment B and twenty-three companies listed on the compartment C of Euronext Paris.⁶

⁴ The AMF Recommendation provides that *"however, the reference framework and application guide are not intended to be binding on companies, particularly companies that have to follow a different benchmark required by other regulations. nor are they intended to take the place of specific regulations applying to certain business sectors, such as banking and insurance."*

⁵ The legal and regulatory framework was presented in the AMF 2010 report on corporate governance and executive compensation on 12 July 2010.

⁶ The full list of the companies included in the sample is presented in the Annex to this report.

1.2 Analysis method

The registration documents and/or annual reports of the companies comprising the sample have been analysed both quantitatively and qualitatively in light of an analysis matrix articulated on the basis of recommended best practice for corporate governance and executive compensation applicable at the Paris financial centre. When drafting this report, the AMF did not conduct interviews with the issuers of the sample.

As regards the parts dedicated to the reference to a corporate governance code ("Reference to a corporate governance code"), the documents and annual reports published in 2009 by the companies comprising the sample have also been reviewed. Moreover, for the purposes of analysing changes in the composition of the boards of directors ("Organisation of the board's work"), the draft resolutions published in 2010 in the French official bulletin of legal notices ("Bulletin des annonces légales obligatoires" - BALO) by the companies comprising the sample have been analysed.

1.3 Structure of the analysis

1.3.1 The AMF 2009 report

Since the samples used in the preparation of the previous reports are different from one year to another and accordingly cannot be compared, there will be no reference to the findings of the AMF 2009 report in this report:

- The AMF 2009 report on corporate governance and internal control (hereinafter referred to as "the 2009 report") was based on a sample of 100 companies, among which fifty were listed on the compartments B (twenty) and C (thirty) of Euronext. The thirty companies comprising the sample this year are mainly listed on the compartment C (77% of the sample against 60% last year). The sample used in the preparation of this report includes only one company listed on the compartment B in common with the sample used in the preparation of the 2009 report and eleven companies listed on the compartment C.
- The AMF 2009 report on executive compensation in listed companies and implementation of AFEP/MEDEF Code was based on a sample of 60 CAC 40-listed or SBF 120-listed companies.

1.3.2 Structure

In order to maintain good legibility all throughout the report, it will be structured as follows for each of the issues addressed:

- a summary of the applicable provisions, recommendations of the Middlednext Code and, as appropriate, the recommendations published by the AMF in the previous years,
- a review of best practice,
- as appropriate, the new AMF recommendations or issues to be addressed.

2. Middlednext Code on corporate governance for small and medium listed companies

Middlednext, a French association representing the medium listed companies, published a corporate governance code for small and medium listed companies in December 2009 (hereinafter referred to as "the Middlednext Code" or "the Code").

According to its preamble, the steps involved in the preparation of this Code "do not conflict with the provisions of the AFEP/MEDEF corporate governance code for listed companies" but "offers an alternative to small and medium listed companies, since some of the provisions in the AFEP/MEDEF are not completely suited to such companies."

In this respect, it stresses that “*small and Midcaps are characterised by their size. They have a wide variety of shareholding structures, however. In particular, many of them have a large reference stakeholder, often holding a majority of the capital, who may be a family or the entrepreneur. The companies are generally managed by the representatives of the majority shareholders (...)*”

The Code further indicates that governance issues will concern finding the right balance between the entrepreneurial freedom of action of the managers who are also, in most cases, the majority shareholders and, as such, bear the main risk in the event of poor management and protecting minority shareholders whose interests might be harmed by certain management decisions, it being understood that the board of directors or, if applicable, the supervisory board, whatever its composition, is a collegiate body which collectively represents all the shareholders and is bound by the obligation to take account of the corporate interest of the company at all times.

The Middenext Code defines and distinguishes, for each power of governance within the company (executive power, supervisory power, and sovereign power), two categories of rules:

- **Points to be watched:** These are the main questions to be asked when seeking to ensure effective corporate governance. Due to the wide diversity of Small and Midcaps, these points to be watched cannot give rise to identical sets of requirements for all companies. The purpose of these points is to incite the board of directors of companies to take a look at their specific issues, without requiring them to give explicit, detailed responses on these points. Companies referring to this Code are asked to indicate, in their Chairman’s Report, that the Board of Directors (or Supervisory Board) has informed itself of the issues presented in the “Points to be watched” section⁷.
- **Recommendations:** These are the rules to be complied with by those companies choosing to adopt this Code. In these cases, the Chairman’s Report must clearly indicate how they apply them and if not, why not, on the basis of the “comply or explain” approach⁸.

It is also pointed out that “*this Code draws on the laws, regulations and recommendations of the AMF that are applicable in such matters. The Code will be amended, if the need should arise, in line with any changes to the legislative or regulatory context.*”

3. Report of the AMF working group on audit committees and update of the AMF reference framework on internal control and risk management systems

The AMF created a working group in October 2009 and tasked it to initiate a reflection on audit committees. This working group drafted a report which was the subject of a public consultation, highlights the main points of the duties entrusted to the audit committee, provides an insight into its area of intervention and its composition, and provides for a process of implementation.

The final report of the working group was published on 22 July 2010 and gave rise to the AMF recommendation 2010-19 on audit committees⁹.

⁷ There are fourteen points to be watched, which appear in the form of questions: **executive power:** Does the manager have the right skills? Is the “manager” isolated? Can the manager’s compensation affect its judgement? Are there arrangements for the succession of the manager? **supervisory power:** Does “supervisory” power overlap with executive power? Are the directors carrying out their supervisory duties effectively? Do the directors have the material means to fulfil their mission? Do the directors have the right skills? Can the work conditions of the directors create bias and affect their judgement? **sovereign power:** Are the shareholders informed of the major foreseeable risks that might threaten the sustainability of the company? Do the shareholders really choose the directors? Do the shareholders take part in votes? Is there the risk of harming the rights of minority shareholders? Is the development of share ownership properly managed over time?

⁸ There are fifteen recommendations which deal with the executive power and the supervisory power. The Code does provide for any recommendation as regards the sovereign power.

⁹ “AMF Recommendation on the report of the working group on audit committees” of 22 July 2010

The reflection of the working group was also the occasion for updating the reference framework on internal control and risk management implemented by the AMF in 2007, by taking into account the legislative and regulatory changes that have taken place since 2007¹⁰. The 2007 reference framework tailored to small and midcaps (VaMPs) has also been updated.

The new versions of the AMF reference framework (“risk management and internal control systems”: Reference Framework) and of the application guide of the Reference Framework (“risk management and internal control systems”: Reference Framework: Application Guide for small- and midcaps”) were published on 22 July 2010 and were the subject of a recommendation of the same date.¹¹

II. CORPORATE GOVERNANCE

Listed companies are legally required to present a declaration on corporate governance in their annual report. This declaration must indicate the corporate governance code the company chooses to refer to and, as per best practice, the provisions of the code that are not complied with by the company and the reasons for not doing so¹². Implementing the “comply or explain” principle is a guarantee of good governance and transparency of the practices used by the companies towards its stakeholders.

It is recommended that companies comply with this code as the standards of the Paris market place are said to include best practice. In order to provide their stakeholders with good information, listed companies must be transparent on this issue in the chairman’s report as regards the preparation and organisation of the Board’s work and as per the internal control procedures introduced by the company.

¹⁰ Indeed, the law of 3 July 2008 and the order of 8 December 2008 transposed into French Law the European directives which impose new obligations on listed companies in terms of risk management and set out the duties of the audit committee.

¹¹ “AMF Recommendation on risk management and internal control systems: Reference Framework” of 22 July 2010.

¹² Article L 225-37 of the Commercial Code

1. Reference to a corporate governance code

1.1 Reference to a corporate governance code

1.1.1 Reminder

- Commercial Code

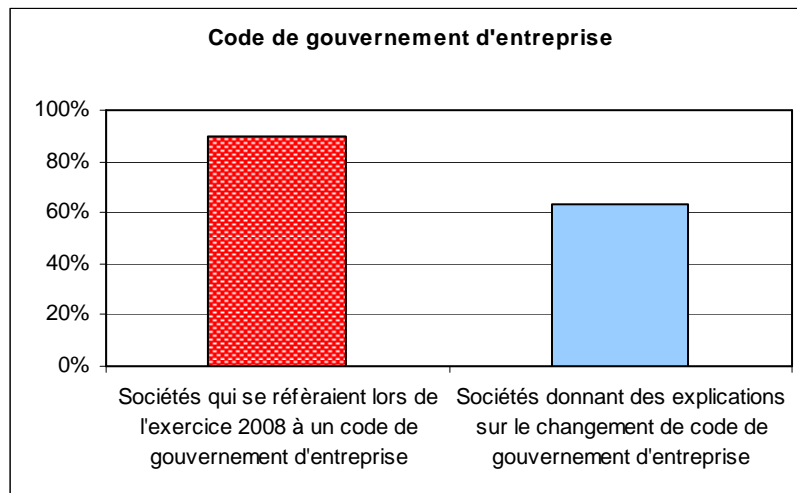
Pursuant to Article L. 225-37 of the Commercial Code: *“If a company voluntarily applies a corporate governance code drafted by industry groups, the chairman’s report should identify any provisions it has chosen not to apply and give the reasons for doing so. The report should also state where the code can be consulted. If the company does not apply a corporate governance code, the report should indicate the rules that it applies in addition to the statutory requirements, and explain why it chose not to apply any of the provisions of this corporate governance code”.*

1.1.2 Findings

The sample taken in this report only includes companies which apply the Middenext Code.

90% of the companies comprising the sample applied the AFEP-MEDEF Code when they drafted their annual reports or registration documents for the financial year 2008.

10% of the companies of the sample did not apply any corporate governance code. Amongst them, one explained why and indicated that it now applies the Middenext Corporate Governance Code for small- and mid-caps of December 2009, due to its compatibility with its size and its shareholding structure.



Amongst the companies comprising the sample, 63% explained why they chose to apply the Middlednext Code as their reference corporate governance code. The following examples can be noted:

- *“In 2009, the supervisory board decided to apply the AFEP/MEDEF Corporate Governance Code. The company complied with a vast majority of the provisions laid out in this code and explained in its 2009 report that the recommendations not yet complied with would be adopted in the coming financial years. Since that date, Middlednext has published in December 2009 a corporate governance code for small- and mid-caps. In regards to the activity, functioning and size of the company, the supervisory board decided (...) to apply the Middlednext Corporate Governance Code. The company complies with a majority of the Code’s provisions and indicates in this report which recommendations are not being complied with and explains the reasons for not applying them, in line with the ‘comply or explain’ principle.”*
- *“In terms of corporate governance, our company has hitherto complied with the AFEP-MEDEF Corporate Governance Code for listed companies of December 2008. It was decided that the company would from now on apply the Corporate Governance Code for small- and mid-caps released by Middlednext in December 2009 (hereinafter referred to as the “Reference Code”), on the grounds that it is more suited to the size and characteristics of the company, in particular because of the presence of a majority reference shareholder and because the company is managed by representatives of the reference shareholder.”*

The vast majority of the companies use clear and precise terminology when it comes to explaining how they apply the Middlednext Code. Thus, 80% of the companies use the terms “refer to” or “reference” and 17% use the words “apply”, “adhere” and/or “adopt”.

Another company specified that it did not decide to refer explicitly to a corporate governance code but that, following the publication of the Middlednext Code, it expressed its wish to apply some of the Code’s recommendations which are tailored to its size and shareholding structure.

In conclusion, virtually all companies comprising the sample make clear and explicit reference to the corporate governance code they use.

Although not a single company of the sample is confronted with this situation, the AMF wishes to remind, in light of the findings arising from its review of the issuers’ financial operations and disclosures, that companies which have expressly decided not to refer to a corporate governance code are required, pursuant to the law, to give the reasons why they decided not to apply any of the provisions of a corporate governance code on the one hand and indicate, on the other hand, the rules they choose to apply in addition to the legal requirements. In other words, in order to comply with the provisions of Article L.225-37 of the Commercial Code, a company cannot confine itself to stating that it chooses not to refer to a corporate governance code or that reference to a code does not seem to be suited or adequate without providing detailed explanations about the reasons that led to this conclusion and without describing the corporate governance rules it effectively introduced.

1.2 Reference to « points to be watched »

1.2.1 Reminder

- MIDDLENEXT Code

“(...) Companies referring to this Code are asked to indicate, in their Chairman’s Report, that the Board of Directors (or Supervisory Board) has informed itself of the issues presented in the “Points to be watched” section (...)”¹³.

¹³ Preamble of the MIDDLENEXT Code.

1.2.2 Findings

For 67% of the companies comprising the sample, the chairman's report indicates that the board was informed of the information disclosed in the "Points to be watched" section. 33% of them (i.e. ten companies) did not communicate on this point and did not provide any explication for omitting reference to the points to be watched.

The AMF reminds that the Middenext Code expressly provides that companies indicate in the chairman's report that the board was informed of the information disclosed in the "Points to be watched" section. In this regard, the AMF noticed that the Middenext Code specifies that the points to be watched *"are the main questions to be asked when seeking to ensure effective corporate governance"* and that *"the purpose of these points is to incite the board of directors of companies to take a look at their specific issues, without requiring them to give explicit, detailed responses on these points."*

It bears noting that one company of the sample drew up a summary table compiling all the points to be watched. This table also reports on the results of an assessment by an audit firm aimed at determining to which extent the company complies with the Middenext Code. According to information compiled, out of the fourteen points to be watched of the Middenext Code, the company was deemed to be compliant with thirteen. As regards the succession of the manager ("Are there arrangements for the succession of the manager?"), the practice of the company was deemed compliant but to be improved. In this regard, the company estimated and explained in the chairman's report that the collegial nature of the management and the creation of an executive committee in late 2009 limit the risks associated with the issue of the management succession plan.

Some companies did not expressly indicate in the report that the board had been informed of the points to be watched and failed to provide any explanation for omitting such information. Considering the importance of this scheme within the Middenext reference framework, the AMF recommends that companies apply this provision of the Middenext Code and, as appropriate, explain in details why the board failed to take account of the points to be watched.

1.3 Implementing the “comply or explain” approach

1.3.1 Reminder

- MIDDLENEXT Code

As regards the recommendations provided for in the Middenext Code, *“the Chairman’s Report must clearly indicate how they apply them and if not, why not, in line with the principle ‘comply or explain’.”*

1.3.2 Findings

Several companies of the sample rejected certain provisions of the Middenext Code, such as those related to the number of independent board members, the drafting of rules of procedure or the self-evaluation of the board. Detailed findings on how these companies rejected these recommendations and, as appropriate, why they decided rule them out, are presented in the parts hereinafter.

Firstly, it bears noting that these companies do not expressly highlight the provisions they decided to reject, thereby preventing effective assessment of the way in which they effectively apply the provisions of their reference code.

In this context, one company declared that it did not reject any of the provisions of the code but then indicated that its board did not draw up rules of procedure, when this document is the subject of the recommendation 6 of the Middenext Code.

2. Organisation of the board’s work

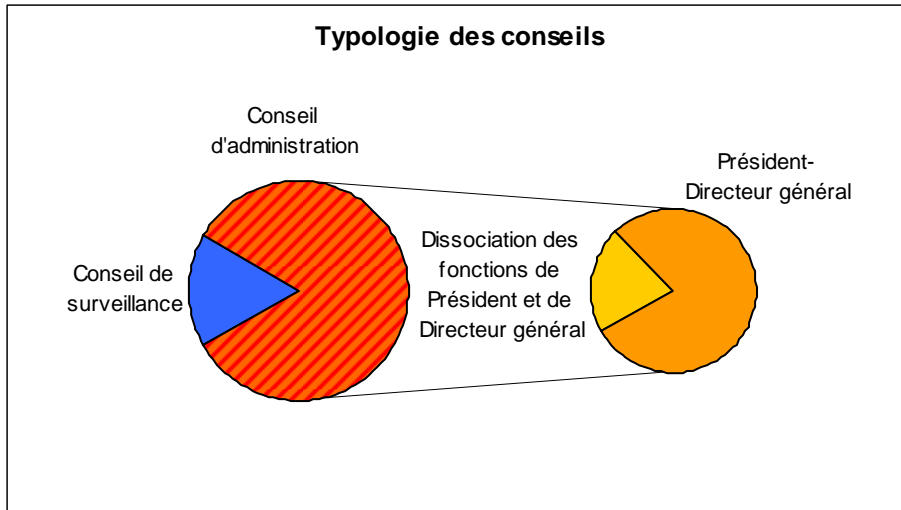
2.1 Typology, size and composition of the boards

2.1.1 Typology of the boards and shareholding structure

77% of the companies comprising the sample have a shareholder which holds at least 20% of the capital of the company and 47% have a shareholder which holds at least 50% of the capital of the company¹⁴.

80% of the companies of the sample have a board of directors and 20% chose to have a supervisory board and a management board. The roles of Chairman and Chief Executive Officer are combined in 79% of the cases.

¹⁴ These findings arise from the data compiled up to 31 December 2009 or, as appropriate, up to later dates closer to the publication date of the registration document or annual report of the company. The statistics is expressed in percentage of the capital only. For the purposes of the preparation of this report, the reference to concerted actions between the shareholders has been, as appropriate, taken into account.



Only one company declared it would separate the roles of Chairman and Chief Executive Officer, upon a proposal by the chairman, as of the date of the next general meeting. In order to explain this change, the Chief Executive Officer expressly referred to its age and to the necessity to make arrangements that would ensure the future of the group, i.e. the extension of the age limit of the chairman of the board, a position he would retain, and the separation of the roles of Chairman and Chief Executive Officer for the remaining time period.

2.1.2 Size and composition of the boards

The boards of directors or supervisory boards have an average of 6 members, ranging from 10 directors at the largest to 3 directors at the smallest¹⁵.

As regards the composition of the board, attention should be paid to the following paragraph in the report by the chairman of one of the companies in the sample: *“the appointment of board members is proposed to the general meeting of shareholders in light of several criteria: capital investment (the percentage of shares and rights to vote), corporate management skills and financial skills and an independent, critical outlook.”*

¹⁵ For the record, the board of directors and supervisory board of the CAC 40- or SBF 120-listed companies comprising the sample used for preparing the “AMF 2010 report on corporate governance and executive compensation” had an average of 13 members.

2.1.3 Independent board members

2.1.3.1 Number of independent board members

1) Reminder

- MIDDLENEXT Code

“It is recommended that the Board should include at least two independent directors. This number may be reduced to one member when the Board has five members or less. This may be increased on boards with a large number of members. (...)”¹⁶.

2) Findings

- Companies with more than five board members

60% of the companies of the sample have a board with more than five members. 89% of these companies have at least two independent board members. Amongst these companies, the average number of independent board members is 3.1.

Two companies with their board comprising six and nine members respectively have only one independent board member.

In order to justify failure to comply with the recommendation of the code:

- The first one argues that, given the number board members, it was not considered useful or relevant to appoint a second independent director at this stage.
- The second company indicates that it is not against the idea of having a second independent director, though highlighting that no candidate meeting the board’s requirements had been identified so far.

The first explanation is not very careful and specific and can hardly be considered as meeting the requirements of the “comply or explain” principle.

- Companies with five board members or less

40% of the companies of the sample have five board members or less. Less than 50% of them have at least one independent board member. The average number of independent directors is 1.3.

One of the companies argued that *“the presence of an independent board member (...) allows preventing the abusive exercise of control as this director could raise the alert, should he detect abuse.”*

Conversely, six companies with five board members or less do not have any independent board member.

¹⁶ Recommendation n° 8 du Code MIDDLENEXT : Composition du conseil – présence de membres indépendants au sein du conseil.

Out of these six companies, one states that it has taken action to comply with the Recommendation of the MIDDLENEXT Code: *"We're currently looking for one or several candidates likely to join the board of directors as independent board members so as to provide the board with additional expertise in certain areas."* Although the situation does not comply with the Recommendation set forth in the Code, this company however does not reject the said Recommendation and indicates in a transparent manner that it is engaged in a research process.

Three companies explain that the composition of their shareholding structure and their size have accounted for their decision to rule out this Recommendation:

- The absence of independent members can be accounted for by the size of the group and by the fact it is controlled by a group of majority shareholders.
- The provision of the MIDDLENEXT Code has been considered ill-suited to the company's particular circumstances in view of its family ownership structure and of the presence of family members on the board of directors.
- Given the majority family ownership structure of company and given the size of the company, the latter does not think it necessary to appoint an independent member to the board of directors. However, the company does not rule out appointing one or several independent members to its board of directors in the future, depending on its development.

The arguments put forward for not appointing an independent member to the board appear to conflict with the philosophy of the Recommendation 8 of the MIDDLENEXT Code, of which the explanation featured in the paragraph "Context" that precedes it is, in this regard, instructive.

The Recommendation provides that: *"large shareholdings may lead the board to over-represent these shareholders' interests to the detriment of minority shareholders and distort strategic vision or representations of the environment. Therefore, boards should be opened up to outside members who contribute a different viewpoint regarding the board's decisions. However, companies are not always big enough to require large boards and they may have difficulty attracting outside members. Therefore, expectations regarding the number of independent directors should remain realistic."*

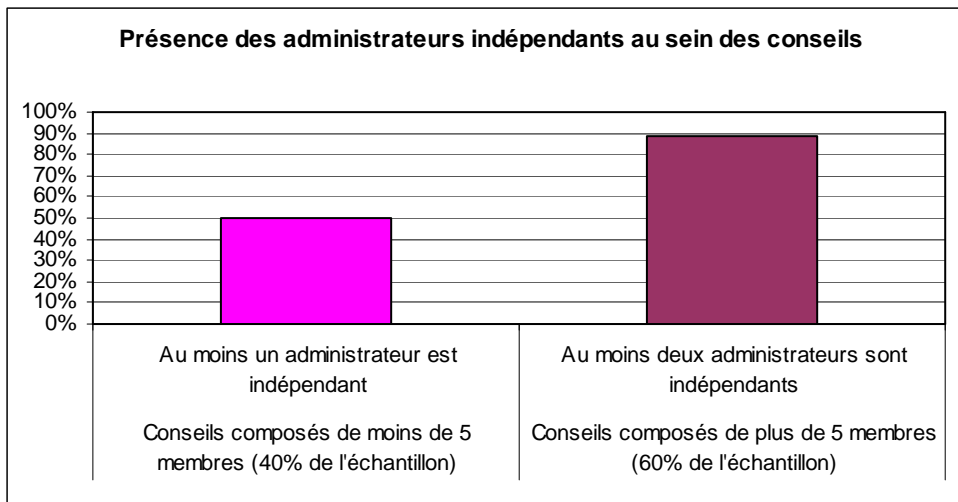
This paragraph echoes passages devoted to the protection of the interests of minority shareholders in the preamble of the Code, and notably recalls that *"the board of directors, or as the case may be the supervisory board, regardless of its composition, is a collegial body which represents all shareholders collectively, and which is required to act at all times in the interests of the Company."*

Consequently, the aforementioned explanations provided by these three companies cannot be considered as meeting the requirements of the "comply or explain" principle.

Lastly, two companies fail to provide any explanation for not complying with the Recommendation of the MIDDLENEXT Code and, thereby, to comply with the "comply or explain" principle:

- One company gives the following reason: *"Having an independent director is mandatory only in the presence of an audit committee. No decision has been made on setting up such a committee."* However, it should be noted that Recommendation 8 of the Code does not make any connection between the presence of an independent member on the board and setting up an audit committee. Accordingly, this explanation cannot be considered satisfactory.
- The other did not provide any explanation.

The aforementioned findings indicate that the number of companies with a board made up of more than five members that comply with Recommendation 8 of the MIDDLENEXT Code on the number of independent members is greater than the number of companies with a board made up of five members or less.



The AMF recommends that companies apply the Recommendation of the MIDDLENEXT Code on the number of independent members on the board or, failing this, prompts them to provide a detailed explanation, other than the size of the company, of its board or its shareholding structure which are already accounted for in the MIDDLENEXT Code, in order to comply with the “comply or explain” principle provided for in the law.

2.1.3.2 Qualification as an independent director

1) Reminder

- MIDDLENEXT Code

Hereinafter are the criteria which allow assessing the independence of board members, *“which is characterised by a lack of material financial, contractual or family connections that could affect the independence of the board member’s judgment”*:

- The director is not an employee, officer or director of the company or a company within its group, and has not held such position during the past three year.
- The director is not a significant customer, supplier or banker of the company or its group, or for which the company or its group represents a significant part of its business.
- The director is not a reference shareholder in the company.
- The director does not have a close family relationship with an officer or director or a reference shareholder.
- The director has not been a company auditor during the past three years.

The board of directors considers the circumstances of each member on a case-by-case basis in view of the criteria set forth above. Subject to supporting its position, the board can view one of its members as independent even where he does not fulfil all these criteria. On the other hand, it is possible that a member who fulfils all of these criteria may not be considered independent¹⁷.

¹⁷ Recommendation 8 of the MIDDLENEXT Code: Composition of the board – presence of independent members on the board.

2) Findings

80% of listed companies have at least one independent member on their board.

54% of listed companies mention the existence of detailed independence criteria and quote the Code:

- Nine companies refer the whole set of independence criteria provided for in the MIDDLENEXT Code.
- Three companies, which refer to the MIDDLENEXT Code, refer to all or part of the independence criteria laid down in the AFEP-MEDEF Code¹⁸.
- One company uses the independence criteria laid down in the AFEP-MEDEF Code as a basis for assessing independence and supplements them with additional criteria when it comes to dealing with the shareholding structure of the company.

38% of the companies refer to the definition of independence provided for in the MIDDLENEXT Code without quoting it explicitly and/or give a general definition of independence:

- Six companies refer to the criteria or definition provided in the MIDDLENEXT Code without detailing them. One out of these six companies expressly referred to the Recommendation 8 of the MIDDLENEXT Code and to Article 8.1 of the AFEP/MEDEF Code.
- Three companies give a general definition of independence such as: *“a director is independent when he or she has no relationship of any nature with the company, its group or the management of either, that may compromise the exercise of his or her freedom of judgment.”*

8% of the companies do not provide any definition of independence or do not recall the definition or criteria provided in the MIDDLENEXT Code. One company nevertheless specifies that the board includes three independent members *“who are not part of the family group”* and that the seniority in office of one of its members has not been affecting his status as an independent director.

Besides, it should be noted that the chairman of the supervisory board of a company was considered independent while also acting as chief executive officer of the main operating subsidiary of the company, which is incompatible with the independence criteria laid down by MIDDLENEXT.

The AMF recommends that companies provide detailed information on the independence criteria they set aside, as appropriate, and on those they choose to endorse and to provide detailed rationale for the way they apply these criteria.

2.1.4 The presence of women on the boards

2.1.4.1 Reminder

- The AMF recommendation

In its 2009 report on corporate governance, the AMF recommended that the issue of appointing women directors be addressed.

¹⁸ *“The criteria that the committee and the board should examine in order to determine whether a director can be called independent and help avoid the risk of 10 conflict of interest between the director and executive management, the company or its group, should be as follows: The director is not an employee or corporate officer (mandataire social) of the company, nor an employee or director of its parent or of one of its consolidated subsidiaries, and has not been one during the previous 5 years, The director is not a corporate officer of a company in which the company holds, either directly or indirectly, a directorship, or in which a directorship is held by an employee of the company designated as such or by a current or former (going back 5 years) corporate officer of the company, The director is not a customer, supplier, investment banker or commercial banker: which is material for the company or its group, or for which the company or its group represents a material proportion of the entity’s activity, The director does not have any close family ties with a corporate officer (mandataire social) of the company, The director has not been an auditor of the company over the past 5 years, The director has not been a director of the company for more than twelve years.”*

2.1.4.2 Findings

a) As on 31 December 2009

As on 31 December 2009, the proportion of women on the boards of directors or supervisory boards of the companies of the sample is on average 13%. However, it should be noted that one of these companies has 75% of female board members. Moreover, 33% of the companies comprising the sample have 20% of women or more on their boards.

47% of the boards are made up of men only.

b) Trends that emerged at the 2010 general meetings

Beyond the trends as found in the reference documents or annual reports released by the companies of the sample in 2010, the proportion of companies proposing that women be appointed to the boards of directors or supervisory boards has also been reviewed¹⁹.

In this context, two companies proposed the appointment of a female director²⁰. After the general meetings, the proportion of female board members will slightly increase from 13% to 13.5% and the proportion of boards made up of men only will decline to 43%, down from 47% as on 31 December 2009.

Conversely, the proportion of companies of the sample which have at least 20% of female board members will remain stable.

2.2 Duties and activity of the board

2.2.1 Duties of the board

83% of the companies describe the duties of the board and 60% provide a detailed description of these duties.

2.2.2 Frequency of board meetings

2.2.2.1 Reminder

- MIDDLENEXT Code

*"It is recommended that the frequency and length of the meetings allow conducting a comprehensive review of the issues addressed. The frequency is at the discretion of the company, depending on its size and its characteristics. However, it is recommended that the board meet at least four times a year. Minutes are recorded for each board meeting. The chairman's report must indicate the number of annual board meetings and the directors' attendance rate."*²¹

¹⁹ The following statistics have been measured on the basis of the information disclosed in the registration documents of the companies comprising the sample and on the basis of the draft resolutions submitted to the 2010 general meetings published in the French official bulletin of legal notices, (Bulletin des annonces légales obligatoires- BALO).

²⁰ An appointment and the ratification of an appointment occurred after the close of the financial year ended December 31.

²¹ Recommendation 13 of the MIDDLENEXT Code: Meetings of the boards and committees.

2.2.2.2 Findings

All the companies of the sample indicate the number of annual board meetings.

The average number of meetings per year stands at 6.46. Only one company of the sample held three annual board meetings, i.e. less than the minimum of four meetings recommended by the MIDDLENEXT Code. However, the company did not give any reasons for ruling out the application of the Recommendation 13 of the Code.

83% of the companies indicated the average directors' attendance rate, which stands at 88% for the entire sample.

Out of the companies which did not published detailed information on the attendance rate of directors:

- Two companies indicated the minimum attendance rate: *"The board of directors (...) met three times in 2009 with an attendance rate of, or superior to, 60% for each meeting"; "at least two thirds of the directors attended the board meetings."*
- Three companies provided no information on the attendance rate, thereby failing to comply with the recommendation 13 of the MIDDLENEXT Code. They provided no specific explanation for omitting such information.

Besides, 77% of the companies of the sample reviewed the board's work.

2.3 The board's rules of procedure

2.3.1 Reminder

- MIDDLENEXT Code

"It is recommended that the board draws up rules of procedure including at least the five following headings:

- *role of the board and, as appropriate, the operations subject to prior approval by the board.*
- *composition of the board /criteria for determining the independence of the board members .*
- *duties of the board members (code of conduct : loyalty, non compete obligations, disclosure of conflicts of interest et duty to abstain, confidentiality, etc...).*
- *functioning of the board (frequency, call for board meetings, information of the board members, use of the videoconference or telecommunications means) and, as appropriate, the functioning of the committees.*
- *rules for determining the compensation of board members.*

It is recommended that the rules of procedure or substantial extracts of it be made available to the public²².

2.3.2 Findings

60% of the companies of the sample refer to the board's rules of procedure. Out of these companies, 72% provide information on the content of the rules of procedure. In this regard, the companies provide clarifications on the following issues:

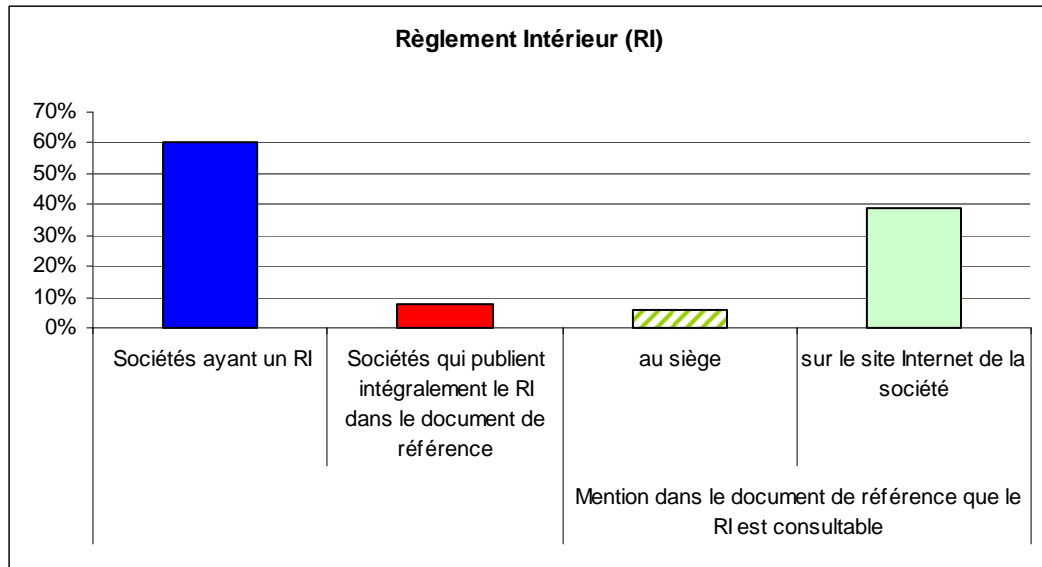
- the functioning of the board (frequency, call for board meetings, information of the board members, use of the videoconference or telecommunications means) and, as appropriate, the functioning of the committees: 92%
- the role of the board and, as appropriate, the operations subject to prior approval by the board: 92%
- the duties of the board members (code of conduct : loyalty, non compete obligations, disclosure of conflicts of interest et duty to abstain, confidentiality, etc...): 69%
- the composition of the board /criteria for determining the independence of the board members: 69%

²² Recommendation 6 of the MIDDLENEXT Code: Introducing rules of procedure governing the board.

- the rules for determining the compensation of the board members : 23%.

As regards the information about the availability of the rules of procedure:

- One company made it available to the public in its entirety.
- One company indicates that the rules of procedure can be consulted at its headquarters.
- 39% of the companies refer readers to their website to consult the rules of procedure.



Out of the 40% of companies which do not refer to any rules of procedure, distinction must be made between four cases:

1. Companies which do not provide any information or explanation on whether or not rules of procedure have been introduced and on whether or not they comply with the Recommendation 6 of the MIDDLENEXT Code

One company is in this situation. The lack of transparency and explanation on this issue does not allow determining whether or not this company complies with the Recommendation 6 of the Code. This practice does not meet the requirements of the “comply or explain” principle.

2. Companies which expressly rule out the Recommendation 6 of the MIDDLENEXT Code but which fail to give any reason why they chose not to introduce rules of procedure.

42% of the companies comprising the sample are in this situation and indicate without further details that they don't have rules of procedure.

Indicating that a Recommendation of the Code is not being complied with without providing further details to justify such a decision is not compliant with the “comply or explain” principle.

3. Companies which rule out the application of the Recommendation 6 of the MIDDLENEXT Code and try to explain why they made this decision

Three companies are in this situation:

- “(...) because of the size of the group or of the board of directors, the board ruled out the application of the following recommendations of the Middlednext Code: -Recommendation on the introduction of rules of procedure (...)”.

- *“the board of directors decided not to draw up rules of procedure given the size of the group, its heritage nature and the deep involvement of its members (officers-shareholders) in the management of the group’s key activities.”*
- *“given the size of the company and of the board of directors, it was not thought necessary to draw up rules of procedure.”*

The size of the company, that of the board and the involvement of the officers and shareholders are the main reasons invoked by these companies to justify their decision to rule out the introduction of rules of procedure.

The context that served as a basis for articulating the Recommendation 6 of the Code must be recalled: *“In most small- and medium-sized enterprises, there is confusion between the three powers, namely the Executive Power, Supervisory Power and Sovereign Power (i.e. the power of the officers, of the board and that of the shareholders) because of the presence of reference shareholders which are often majority shareholders. Accordingly, it should be specified as explicitly as possible what the directors expect from the rules of procedure, which are drawn up according to the company’s particular circumstances”.*

In light of this presentation, arguing that the concentration of « officers-shareholders » accounted for the decision to rule out the introduction of rules of procedure is not consistent with the “comply or explain” principle.

4. Companies which admitted non-compliance with the Recommendation 6 of the MIDDLENEXT Code and committed to remedying in their disclosures

Three companies are in this situation:

- *“Given the recent adoption of the Middlednext Corporate Governance Code, the rules of procedure have not yet been drawn up but they will be by 30 June 2010”.*
- *“The rules of procedure governing the board of directors is currently being drawn up and will be debated by the board of directors in the course of the 2010 financial year” .*
- *“The group (...) intends to comply with the AMF recommendations and with the Middlednext Code for improved corporate governance. In this spirit, the board of directors (...) decided to formalise rules of procedure before the end of the financial year, which should further facilitate the directors’ work and the functioning of the board.”*

Although they clearly indicate that they do not have rules of procedure, thereby failing to comply with the Recommendation of the MIDDLENEXT Code, these companies differ from those belonging to the other aforementioned companies insofar as they do not rule out the Recommendation 6 as a matter of principle and commit publicly to comply with it in the future.

The MIDDLENEXT Code recalls that it should be specified as explicitly as possible what the directors expect from the rules of procedure, which are drawn up according to the company’s particular circumstances. In this context, it is recommended that companies introduce rules of procedure. Consequently, the AMF recommends that companies which did not introduce rules of procedure provide details explanation as to why not in order to comply with the requirements of the “comply or explain” principle laid down in the law.

2.4 Restrictions on the powers of the chief executive and its deputies

2.4.1 Reminder

- Commercial Code

Article L. 225-37 of the Commercial Code provides that: “(...) *without prejudice to the provisions of Article L. 225-56, this report [chairman’s report] also indicates the potential limitations to the powers of the chief executive officer imposed by the board*²³.”

2.4.2 Findings

All companies with a board of directors included in the sample communicate on the existence or non-existence of restrictions on the powers of the chief executive officer.

Out of these companies, 33% impose restrictions on the powers of the chief executive officer.

Restrictions on the chief executive officer’s powers concern essentially the making of important decisions, in particular those related to:

- the company’s strategic areas of development (in particular the scope of its activities),
- investments and divestments, debt, takeovers, disposals, partial mergers, restructurings, whether they exceed an amount predetermined by the board or not,
- approvals for sureties, endorsements and guarantees,
- the implementation of a share redemption programme beyond a certain amount.

3. Implementation, composition and role of the board’s specialised committees

3.1 Specialised committees

3.1.1 Reminder

- Commercial Code

Article L. 823-19 of the Commercial Code requires establishing an audit committee: “*In entities whose securities are listed on a regulated market, a specialised committee acting exclusively under the joint responsibility of the members of the board of directors or the supervisory board, as applicable, shall monitor issues relating to the preparation and review of accounting and financial information (...)*”. “*The membership of the committee shall be determined by the board of directors or the supervisory board, as the case may be. The members of the committee must be non-executive members of the administrative body or the supervisory body. At least one member of the committee shall have special competence in accounting or auditing and shall be independent according to specified criteria disclosed by the administrative body or the supervisory body*”²⁴.

²³Article L. 225-56 of the Commercial Code provides that: « I. - *The Managing Director is invested with the most extensive powers for acting in the Company's name under any circumstances. He exercises the said powers within the limits of the business purpose and subject to the powers explicitly assigned by law to the shareholders' meetings and to the board of directors (...)* The provisions of the By-laws or the decisions of the Board of Directors limiting the powers of the CEO may not be invoked against third parties.. II. - *In agreement with the managing director, the Board of Directors determines the extent and the duration of the powers granted to the deputy managing directors. With respect to third parties, the deputy managing director(s) has/have the same powers as the managing director*».

²⁴ These provisions shall apply upon expiry of an eight-month period after the close of the first fiscal year starting 1 January 2008 during which the term of office of a member of the board of directors or supervisory board has expired.

Article L.823-20 of the Commercial Code provides that *“The following are exempted from the obligations stipulated in Article L. 823-19: (...) 4° Persons and entities that have a body that performs the functions of the specialised committee stipulated in Article L. 823-19, provided that this body, which may be the administrative body or the supervisory body, is identified and its membership is disclosed.”*

- MIDDLENEXT Code

“It is recommended that each company decides, according to its circumstances, whether to set up ad hoc specialised committees (audit committees, compensation committees, appointment committees, strategic committees...) or not. The company shall decide, pursuant to the applicable regulation and according to its particular circumstances, whether to set up an audit committee or to entrust its board with the duties generally assigned to the audit committee under those conditions laid down by law.”²⁵

3.1.2 Findings

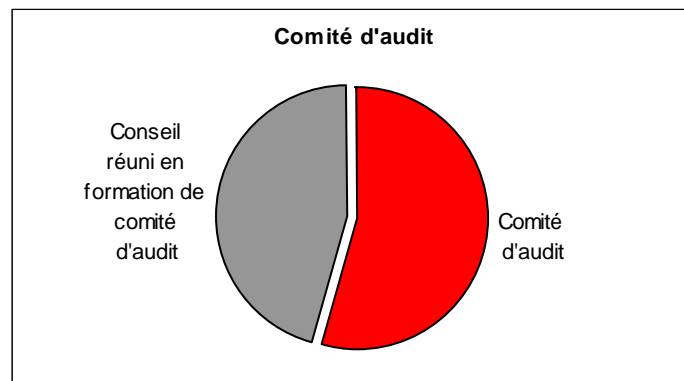
50% of the companies of the sample do not have any specialised committee.

3.1.2.1 The audit committee

1) Setting up an audit committee as a whole

43% of the companies of the sample set up an audit committee.

Eleven companies explain that the absence of an audit committee can be explained by the fact that the board has decided to perform the duties of the specialised committee, pursuant to Article L.823-20 4° of the Commercial Code.



The information relating to this issue provided by most of the companies in such circumstances is generally very explicit. For illustration purposes, the following example can be referred to: *“given the small size of the board of directors, no committee was specifically set up. The directors will themselves perform the duties assigned to the committees (including the audit committee pursuant to the provisions of Article L.823-20 paragraph 4 of the Commercial Code.”* However, certain companies provide less accurate information: *“the board of directors met twice to discuss the audit of the financial statements (half-yearly and yearly) on the basis of a detailed audit report (...)”*, thereby prompting questions about whether these companies effectively entrusted their board with the duties usually assigned to the audit committee.

Three companies justify their decision not to set up an audit committee on the grounds that some board members have had their directorship renewed before the provisions governing the setting up of an audit committee came into force. They committed to comply with the legal provisions at the latest at a date specified in their report. The

²⁵ Recommendation 12 of the MIDDLENEXT Code: Setting up committees.

following example can be referred to: *“not a single term of office of a director has expired (...). Consequently, [the company] is not obliged to set up an audit committee or to hold board meetings to perform this duty.”*

Lastly, one company fails to provide any explanation as to why it did not set up an audit committee and two other companies do not provide any information on whether they were considering setting up an audit committee or not. In this regards, it should be noted that the chairman’s report of one these companies, which was presented to the 2009 general meeting (for the year 2008), stated that an audit committee made up of three directors was set up several years ago. However, this is no longer mentioned in the 2009 chairman’s report, with the company failing to indicate whether the audit committee is still operating as an audit committee as a whole or whether the board is now performing the duties usually assigned to the audit committee.

These three companies fail to meet the requirements of the Recommendation 12 of the MIDDLENEXT Code.

2) The composition of audit committees

Audit committees are made up of an average of 3.1 members and include an average of 1.9 independent members, i.e. a 67% rate.

In 58% of the cases, the chairman of the audit committee is independent.

85% of the companies indicate the number of meetings (a little more than 3 meetings per year) and 62% indicate the attendance rate, which stands at 94%.

85% of the companies indicate the duties that fall to the audit committee and 77% took stock of the audit committee’s activities.

When it comes to the composition of certain committees, some of the practices described are as such as to raise questions as regards compliance with the provisions of Article L.823-19 of the Commercial Code which state that: *“The committee must be composed entirely of non-executive members of the board of directors or the supervisory board”*.

- One company with a supervisory board and a management board reports that its audit committee is made up of four persons, including one member of the management board.
- Another one reports that its audit and risk management committee is chaired by the director of data systems and internal audit, who is also a director of the company and a member of its management board.”

3) Information on the functioning of audit committees

Companies provide the following special information on the functioning of audit committees:

- One of the companies of the sample drew up a specific document entitled “activity report of the audit committee”, which states in particular that: *“The audit committee reviewed the company’s financial disclosures. Beyond its direct contact with the company’s senior management, the audit committee was able to speak freely with the auditors so as to be provided with the additional information and clarifications needed”*.
- Another one stipulates that: *“the committees may, at their discretion, hold meetings with or without the presence of the management board members. In particular, the audit committee (...) in charge of reviewing the 2008 financial statements met with the statutory auditors without the presence of the management board members.”*

The AMF recommends that companies indicate whether they set up an audit committee as a whole or not and, as appropriate, refer explicitly to Article L. L.823-20 4° of the Commercial Code, should they decide to entrust their board of directors or supervisory board with the duties that usually fall to the specialised committee. Moreover, the AMF reminds that the committee can only be composed of board members. It also recommends that companies which choose to entrust their board with the duties usually assigned to the specialised committee provide details of the operating rules of the board when it meets as the audit committee. In this regard, it is reminded that the AMF working group on audit committees, the report of which gave rise to the AMF recommendation 2010-19, recommended that where the chairman of the board is an executive director, he should refrain from attending any meeting when the board meets as the audit committee²⁶.

3.1.2.2 Other committees

1) Existence and composition of the other committees

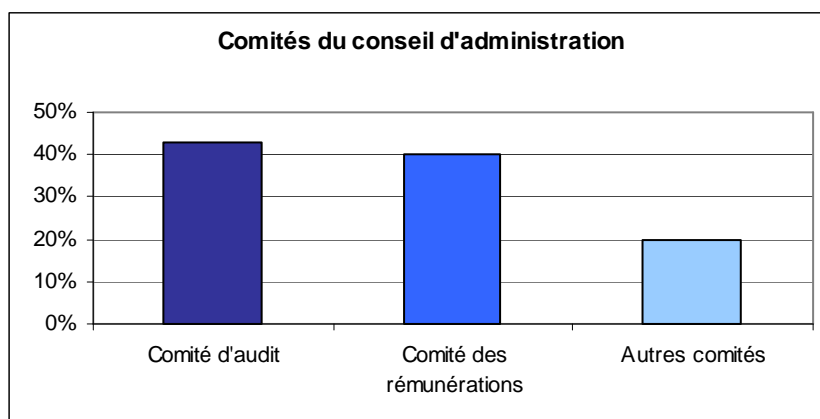
The MIDDLENEXT Code does not specifically provide for setting up other committees within the board and it leaves it to each company to decide whether or not to set up one or several ad hoc specialised committees according to its particular circumstances²⁷.

In practice, 40% of the companies of the sample set up a compensation committee, which also acts as the appointments committee for 50% of these companies.

The compensation committee is made up of an average of 3.6 members and 2 independent members.

Several companies provided justifications for not setting up board committees²⁸ such as:

- *“The board has not considered it necessary, to this day, to set up specialised committees both because of the company’s structure and economic model and because of the in-depth and multidisciplinary experience of its directors in the business world and in the international competitive markets. This mode of operation contributes to the flexibility of its decision-making process”.*
- *“the company (...) considers that its structure and size do not require setting up a compensation committee and an appointments committee”.*



²⁶ However, the chief executive officer may be invited to attend part of the meeting.

²⁷ Recommendation 12 of the MIDDLENEXT Code: Setting up committees.

²⁸ Aside the specific reasons given for audit committees.

4. Evaluation of the board's work

4.1 Reminder

- MIDDLENEXT Code

"It is recommended that once a year, the board's chairman invites board members to give their opinion on the way the board operates and on the preparation of its work. This discussion shall be recorded in the minutes of the meeting²⁹."

4.2 Findings

40% of the companies reported they carried out an evaluation of the board's work during the 2009 financial year and/or during the 2010 financial year in respect of the year 2009. The following can be mentioned for illustration purposes:

- *"Once a year, the supervisory board holds a debate on its functioning and on the performance of the group's executives. It may request that an external consultancy carry the assessment"* .
- *« the review of the chairman's report and the debate arising from its approval allow the board of directors to review the work completed during each fiscal year and the way it operates. The board of directors considers that this stands as the procedure for assessing the board's work and that, in that respect, it complies with the Middlednext recommendations"*.
- *«the board of directors assessed its capacity to meet the shareholders' expectations (...). After reviewing all the elements available, the board concluded that the composition, organisation and functioning of the board of directors comply with the corporate governance rules. It has been agreed upon that, for the current fiscal year, the chairman will invite the board members to voice their opinion on the functioning of the board and on the preparation of its work. This discussion will be recorded in the minutes of the meeting."*

20 % of the companies announced plans to conduct an assessment for the year 2010. The following can be used for illustration purposes:

- *« the company's management complies with all the provisions of the Middlednext code, excluding two points (...), it does not assess the board's work. It will take measures to comply with the two provisions in the course of the 2010 fiscal year."*
- *"to this day, the company has not been able to formalise the procedure for assessing the board's work and functioning because of the characteristics of its structure and because of the way it operates. Although it encourages the exchange of views, the company intends to apply the Middlednext recommendations which promote the principle of self-oversight by directors and their ability to perform annual assessments on the effectiveness of their operating procedures. For this purpose, the chairman will invite the board members to give their opinion on they way the board operates and on the preparation of the work once a year. This discussion will be recorded in the minutes of the meeting."*

²⁹ Recommendation 15 of the MIDDLENEXT Code: Introduction of Board evaluation. This Recommendation is preceded by the following text (Context) : *"Given the characteristics of Small and Midcaps, formal external evaluation is not indispensable, although it may prove useful as a means of providing a fresh insight into company practice. The emphasis should be placed on internal assessment by the directors and on their ability to evaluate the relevance of their work on an annual basis."*

Out of the twelve remaining companies, five indicate explicitly that they ruled out the application of the Recommendation of the MIDDLENEXT Code:

- Two companies have ruled out the Recommendation without providing any particular explanation.
- Three companies say that the size of the group or board has accounted for their decision to rule out the application of the MIDDLENEXT Code.

Seven other companies do not provide any information about the evaluation of the board.

The AMF considers that the companies which fail to provide any information on the assessment of the board or which rule out the application of the Recommendation without providing any explanation do not meet the requirements of the Recommendation 15 of the MIDDLENEXT Code and of the “comply or explain” principle. Moreover, as regards some explanations provided by the companies to justify their decision to rule out this Recommendation, the size of the company or the size of the board does not seem as such as to make the assessment of the company’s board irrelevant, and this all the more since the MIDDLENEXT Code is intended to apply to smaller listed companies, by definition, or to companies with a board comprising fewer members than some companies which do not belong to the small- and midcap category.

The MIDDLENEXT Code recommends that the self-assessment of the board be conducted each year. The AMF recommends that companies which do not comply with this Recommendation provide a detailed explanation for not doing so in order to comply with the requirements of the “comply or explain” principle provided for in the law.

III. EXECUTIVE COMPENSATION

As regards executive compensation, this report chiefly deals with:

- The concurrent holding of an employment contract and corporate office
- Severance payments
- Stock-options and the allocation of bonus shares.
- The definition and transparency of the variable executive compensation

The thirty companies comprising the sample have a total of 77 executives³⁰ (chairmen of the board of directors, chief executive officers, managing directors, deputy managing directors, chairmen of the management board, vice-chairmen of the management board, members of the management board), broken down as follows:

Position	Number of executives	Percentage
chief executive officer	19	25 %
Chairman/vice-chairman of the management board	6	8 %
Chairman of the board of directors	5	6 %
Managing director	12	16 %
Deputy managing director	28	36 %
Member of the management board	7	9 %
TOTAL	77	100%

➤ Summary table by categories of executive

The table below shows, by categories of executive, the percentage of executives who have an employment contract, receive severance payments and/or non-competition payments and, as appropriate, stock options, bonus shares or a variable compensation component.

The information disclosed hereinafter does not merely result from the information compiled by the companies in the summary table recommended by the AMF (Table 10). It has been drawn up from all data disclosed by companies in their registration document.

However, it should be specified that 63% of the companies used the summary table recommended by the AMF in their registration document.

The AMF notes that the executive directors of 33% of the companies of the sample, i.e. ten companies out of thirty, have a fixed salary only.

³⁰ In its corporate governance code for small- and midcaps, MIDDLENEXT considers that the non-executive chairman of the board of directors belongs to the category of executives defined as follows for the purpose of the recommendations set forth in the Code : *"the executives are, depending on the situation, the chairman, the managing director and the deputy managing director in companies with a board of directors, the chairman and the members of the management board in public limited companies with a management board and a supervisory board and the manager in limited stock companies."*

	Number of executives by category	Executives with an employment contract		Executives receiving a severance package		Executives receiving stock options		Executives receiving bonus shares		Executives receiving variable compensation	
		Number	%	Number	%	Number	%	Number	%	Number	%
Chairman of the board of directors	5	2	40%	1	20%	0	0%	0	0%	2	40%
Chief executive officer	19	2	11%	0	0%	2	11%	1	5%	10	53%
Chairman of the management board	6	3	50%	3	50%	0	0%	0	0%	4	67%
Managing director	12	3	25%	4	33%	1	8%	0	0%	8	67%
Deputy managing director	28	N/A		4	14%	2	7%	1	4%	15	54%
Member of the management board	7	N/A		1	14%	1	14%	2	29%	5	71%
TOTAL	77	10	13%	13	17%	6	8%	4	5%	44	57%

1. The concurrent holding of an employment contract and corporate office

1.1 Reminder

Given the size of the companies it is aimed at, the MIDDLENEXT Code recommends that *“Board of Directors should assess whether or not to authorise managers to have employment contracts when they are serving as corporate officers [...]. The report to the general meeting explains the grounds for this decision³¹”*.

This provision is aimed only at the chairman of the board of directors, the chief executive officer, the managing director in companies with a board of directors, the chairman of the management board and the manager in joint stock companies.

1.2 Findings

- Nine companies out of the thirty comprising the sample, i.e. 30% of the sample, report that their executive directors concurrently hold an employment contract and corporate office. Twenty companies report that their directors do not have an employment contract. One company does not provide any information on the matter.

Four companies out of the nine concerned report plans to address the issue of their senior executives combining an employment contract and corporate office upon renewal of their directorship after 2010. One of the companies already said that it does not wish to see its chief executive deprived of the benefits associated with his status as a group employee when he was appointed to the position after 15 years' of service within the company. Moreover, this company believes that the benefits associated with the status of employee granted to this director *“have not appeared to be exorbitant to the Board, in particular considering the absence of contractual severance in respect of the employment contract alongside the applicable compensation agreement in respect of corporate office and compared to other compensation. On the other hand, it did not consider it desirable to introduce unequal treatment between the chairman of the management board and the other members of the management board, who are also*

³¹ Recommendation n° 1 du Code MIDDLENEXT : Cumul contrat de travail et mandat social.

managing directors but are not covered by the recommendation, while they have similar powers in a management body which has a collegial form under the law.”

The AMF reviewed in particular the policy adopted by five companies out of the nine concerned in the sample in 2009 and early 2010 upon renewal of the terms of office of those executive directors with an employment contract:

- Two companies of which the executive directors have an employment contract with other companies of the group have decided to maintain their employment contracts:
 - One company reports that its chief executive officer has an employment contract with its reference shareholder under an employee assignment agreement entered into by the listed company and its shareholder.
 - The second company reports that the managing director and chairman of the management board of another company have an employment contract with a subsidiary.

These two companies accurately describe the personal circumstances of the directors concerned in their registration document but fail to give any explanation for their decision to maintain their employment contract.

- Three companies report that they have expressly decided to maintain the employment contract of their executive directors. Some of them provided explanations for their decision in their registration document, in line with the “comply or explain” principle.

Two companies argued that the loss of benefits associated with the status of employee does not seem to be justified for their executives, in particular since they have considerable experience as group employees. Indeed, should the employment contract be terminated (with immediate effect or upon renewal of the terms of office), companies shall report that terminating the employment contract may result in the director losing many of the benefits he received as a paid executive : pension scheme, contractual compensation in respect of termination of the employment contract, social security...

In that respect:

- One company reports that the decision to maintain the employment contract of its directors was justified by *“the size of the company, the existence of separate technical functions, all well previous to the period when the directors took office, and by the overall consistency aimed at by aligning all the status of the collaborators with that of the directors (social security, health insurance, activities of the works council...)”*
- One company whose managing director has been appointed in 2010 reports that the decision to maintain the employment contract of the director was motivated by its twenty years’ length of service in the company.

A third company fails to provide careful explanations for its decision to maintain the employment contract of its director:

- The third company only reports that its board considers it to be *“very appropriate to allow the director to concurrently hold an employment contract and corporate office given the history of the company.”*

Nine companies out of the thirty comprising the sample (30%) report that their executive directors combine an employment contract and corporate office.

Out of those nine companies, five which renewed the terms of office of their executive directors with an employment contract in 2009 and early 2010 decided to maintain the said employment contract of their executive directors.

Two companies justify their decision to maintain the employment contract of their directors by their seniority in the group. The AMF considers that a company complies with the Code when it justifies the decision to maintain the employment contract of one of its directors by its seniority as a group employee and by its personal circumstances. A third company fails to provide a clear explanation for its decision to maintain the employment contract of its director. Two companies report that their executive directors have an employment contract with another company of the group. These three companies properly describe the personal circumstances of the directors concerned in their registration document but fail to provide any information about their decision to maintain the employment contract of their directors.

The AMF recalls that the MIDDLENEXT Code recommends that the board of directors provide detailed explanations for its decision to maintain the employment contract of an executive. Consequently, the AMF recommends that the reasons for the decision be presented in a careful and detailed manner by the company in its registration document.

As such, the AMF recommends that the board of directors determine whether or not the rule which provides that an employment contract and corporate office can be held concurrently applies to staff holding corporate office in a listed company and with an employment contract with another company of the group.

2. Severance payments

2.1 Reminder

Under the “TEPA” Act, compensation or benefits due or that may be due to executives on appointment or termination or following a change of position are subject to the same procedure as regulated agreements, and also to compliance with criteria linked to the beneficiaries’ performance. Commitments entered into by listed companies in this area are also subject to approval at a shareholders’ general meeting by way of a specific resolution for each beneficiary, and no payment may be made until the board of directors or supervisory board has confirmed that the criteria laid down have been met.

The provisions arising from the TEPA Act are applicable to commitments entered into with effect from 22 August 2007, the date on which the Act was published. As regards the commitments outstanding at that date, the companies concerned have been given eighteen months, i.e. until February 2009, to comply with the requirements arising from the TEPA Act.

The MIDDLENEXT Code defines additional requirements in order to monitor severance payments to executive directors:

- corporate officers leaving the company of their own volition to take up a new job or moving to another post within the same group shall not receive severance payments.
- severance payments shall not exceed two years of compensation (baseline and variable), including compensation paid in respect of the employment contract, unless the manager’s remuneration is known to be disconnected from the market.
- Any artificial swelling of the salary during the period preceding the departure should be prohibited.³²

2.2. Findings concerning executives leaving their company

- The AMF finds it that the information on severance payments to executive directors is rarely detailed in the registration documents of the companies of the sample. Two companies report in their registration document that they granted pension benefits upon retirement of the deputy managing director and that the chief executive officer was due allowances of €255,000 in respect of the financial year 2009. These two companies do not provide any details on the requirements and arrangements for paying the compensation. However, in the last case, the amount of the compensation is lower than two years’ compensation.

Out of these 8 companies:

- One company pays annual bonuses to some executive directors. The bonuses are measured on the basis of the company’s net consolidated income and serve as *“advance compensation for the termination of a directorship and for the non-competition covenant. In return, directors expressly waive their right to severance payments upon termination of their directorship, for whatever reason, unless the directorship is terminated for frivolous reasons.”*

³² Recommendation 3 of the MIDDLENEXT Code: Golden handshakes.

- Five companies report explicitly that the amount is capped at two year's compensation.
- Four companies report that severance payments are contingent upon achievement of internal performance targets detailed in the registration document.

Examples of criteria applied:

- One company reports that severance payments are contingent upon the average ratio of profit from recurring operations of the reference period being at least equal to the operating profit for the financial year 2007.
- One company reports that this commitment is contingent upon performance criteria which depend on net consolidated income.
- One company reports that performance criteria governing the granting of benefits require that the average consolidated operating margin of the last three financial years be higher or equal to 80% of the average consolidated operating margin of the three preceding financial years.

The AMF notes that companies in the sample rarely provide information on severance payments to executive directors in their registration documents. It recommends that companies provide a detailed presentation of the provisions governing severance payments to each executive director in their registration document and specify the arrangements for paying them.

Moreover, in order to improve access to the information and the legibility of the information, the AMF recommends that companies use the table 10 of its Recommendation, which compiles the information relating to the employment contract, severance payments and non-competition benefits and to the existence of a benefit pension scheme.

3. Granting stock options, performance shares or stock warrants

3.1 Reminder

Articles L.225-185 and L. 225-197-1 of the Commercial Code require that executive directors hold a certain number of securities during their term of office.

The MIDDLENEXT Code aims to provide a framework for granting stock options, performance shares or stock warrants so that *"the company's policy in this area be adapted to its particular circumstances and integrated into a reasonable, comprehensive approach, taking into account the interest of the company, the market practices and the performance of the managers."* It sets out the conditions under which they may be granted, as well as the conditions governing their price and exercise:

- **Conditions under which the following securities may be granted**
 - Options and shares must not be excessively concentrated in the hands of managers.
 - Stock options or bonus shares must not be granted to executive directors on their leaving the company.
- **The exercise of stock options or the allocation of part of, or all, bonus shares by executive directors** must be contingent upon relevant performance criteria which reflect the medium-term or long-term interest of the company³³.

Moreover, the AMF recommends that companies use the existing template tables to provide summary information on the different option or share allocation schemes and about the first ten group employees who are not executive directors and benefit from the plan.

³³ Recommendation 5 of the MIDDLENEXT Code: Stock options et attribution gratuite d'actions.

3.2 Findings

- **In 2009, five companies out of the thirty comprising the sample, i.e. 17%, report that they granted stock options or bonus shares.**
- **Four companies out of thirty, i.e. 13% of the companies comprising the sample, report that they have granted stock options:**
 - One company explains that the granting of stock options is contingent upon performance criteria based on the company's income (the company's real average income growth compared to the achievement rate of the company's average revenue growth target).
 - One company reported that the exercise of options is only contingent upon the grantee being present upon expiry of the scheme.
 - Two companies do not provide any information on the implementation of performance criteria.
- **One company indicates that its executive directors have received bonus shares.**

This one company made full allocation of shares contingent upon internal performance criteria (profitability of the capital invested) and on the absence of any additional financial contribution by the company's majority shareholder, in whatever form it takes, until shares are fully allocated. Besides, this company reports that full allocation of shares is contingent upon the grantee being present. Considering the current account contribution of the majority shareholder, those shares have not been distributed.

- **Two companies out of the five that granted stock options or performance shares in 2009 stipulate that their directors are required to hold a predetermined number of shares arising from the exercise of options until their term of office expires.**
- **Three companies report that their executive directors were granted stock warrants in 2009. Another company changed the characteristics of the stock warrants issued in 2007. These companies accurately describe the characteristics of these stock warrants in their registration document.**

Thus, only five companies out of the thirty comprising the sample, i.e. 17%, report that they distributed stock options or bonus shares in 2009. Out of these five companies, two specify in their registration document that the exercise of stock options is contingent upon performance criteria. One company indicated that the exercise of stock options is contingent upon the grantee being present upon expiry of the scheme.

The AMF considers that the presence of the grantee at the time the options are exercised and the stocks fully allocated cannot possibly be considered as a performance criterion.

Moreover, the AMF recalls that the Middenext Code recommends that the exercise of all or part of the stock options and the final allocation of bonus shares to the executive directors be contingent upon relevant performance criteria which reflect the medium-term or long-term interest of the company. Two companies out of the five that distributed stock options or bonus shares in 2009 stipulate that their directors are required to hold a predetermined number of shares arising from the exercise of stock options until their term of office expires. The AMF recalls that directors are required to hold shares for a mandatory period.

The AMF recommends that companies disclose information on the obligation to hold shares in their registration document, as required in Articles L. 225-185 and L. 225- 197-1 of the Commercial Code.

4. Variable compensation

4.1 Reminder

The MIDDLENEXT Code recommends that the board of directors of each company determine the level of executive compensation and disclose information on this issue, pursuant to the applicable legal and regulatory requirements and according to the following seven principles: comprehensiveness, balance, benchmark, consistency, legibility of the rules, measurement and transparency³⁴.

4.2 Findings

- **Nineteen companies of the thirty comprising the sample, i.e. 63%, report that they offer variable compensation to their executive directors.**
 - Three companies of the sample report that variable compensation is contingent upon performance criteria and specified these criteria. One of these three companies indicates that the remuneration of the chairman of the management board depends on two factors: the group's net consolidated profit after taxes (profit) and the amount of the company's consolidated equity at the start of the financial year (private equity)
 - Eleven companies indicate that variable compensation is contingent upon performance criteria but do not provide any information on these criteria.
 - Five companies fail to indicate whether or not variable remuneration is contingent upon performance criteria in their registration document. Out of these five companies, two specified that the amount of variable compensation is a percentage of the group's net consolidated profit or group's consolidated net profit before taxes.

Thus, nineteen companies out of the thirty comprising the sample, i.e. 63%, report that they offer variable compensation to their executive directors. Out of these nineteen companies, three stipulate the performance criteria for determining the amount of variable compensation of their executive directors, eleven companies indicated merely that variable compensation is contingent upon performance criteria and five companies do not stipulate whether or not variable compensation is contingent upon performance criteria.

Pursuant to Article L. 225-102-1 of the Commercial Code, the AMF recommends that companies provide comprehensive information on the criteria for granting and paying variable compensation (the grounds for offering variable compensation, the criteria governing the allocation of variable compensation, arrangements for setting the amount of variable compensation).

IV. Internal control

The DDAC Act adopted on 3 July 2008 containing various provisions to bring France's company law into line with European law amended Articles L. 225-37 and L. 225-68 of the Commercial Code to expand the scope of the chairman's report on internal control procedures so as to encompass the risk management procedures implemented by the company. Accordingly, the AMF working group on audit committees updated the reference framework for risk management and internal control systems and the guidelines for implementing the reference framework for small- and midcaps by inserting a section on risk management.

³⁴ Recommendation 2 of the MIDDLENEXT Code: Definition and transparency of the compensation of corporate officers.

These updates were published in their final form on 22 July 2010, i.e. after the registration documents and annual reports of the companies comprising the sample on which this report is based were drafted.

Consequently, the findings in the following parts, when they deal with the AMF reference framework for small and midcaps and the guidelines for implementing it, refer to the versions of these two documents drafted before 22 July 2010.

1. Reference to a code

1.1 Reminder

- The AMF recommendation

In its 2009 report, the AMF called on companies to specify in the chairman's report whether they have relied on the AMF reference framework or guide for implementing the reference framework when drafting the report. Where the reference framework or guide is applied only partially, companies should clearly identify the areas or key internal control processes they implemented, taking into account the nature of their business, their size and their form of organisation. The same principles of transparency should apply to any other framework that the company chooses to use or is required to implement at the international level and that should therefore be disclosed. The AMF encourages companies that do not currently use a framework to be more explicit about this point.

1.2 Findings

1.2.1 Referring to reference framework

50% of the companies of the sample refer to a specific framework for internal control.

Out of these companies:

- 87% of the companies refer to the AMF reference framework solely.
- One company indicated that the internal control framework it implemented relied both on the guidelines for implementing the AMF reference framework for small- and midcaps and on the Enterprise Risk Management approach arising from the work of the Committee Of Sponsoring Organization of the Treadway Commission which supplements the AMF internal control framework.
- another company specified that it had drawn up internal control procedures on the basis of the provisions of Article 404 of the Sarbanes Oxley Act while stressing that the principles laid down in this Act can be found partly in the AMF reference framework of January 2007, which was supplemented by the guidelines for implementing the reference framework for small- and midcaps on 9 January 2008.

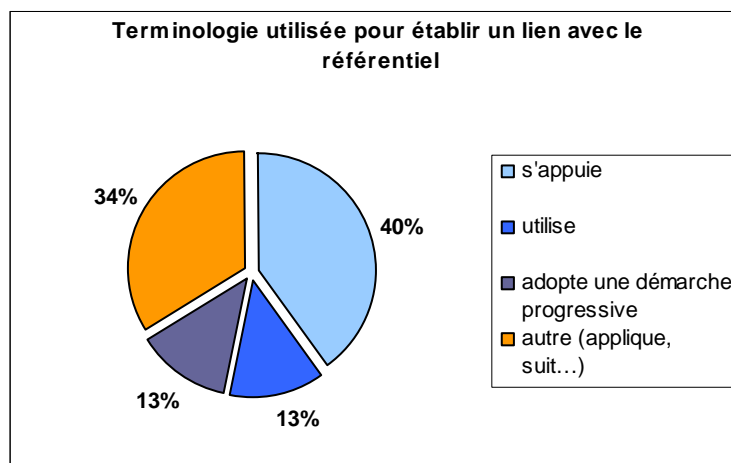
1.2.2 Terminology used to refer to a reference framework

In its 2009 report, the AMF revealed that while companies tend to use a reference framework for internal control, the terminology used could prove to be a source of uncertainty when it is not accurate enough.

In this regard, it bears noting that:

- 40% of the companies use the verb “rely” (“by relying”, “relied”, “relies”).
- 13% use the verb “use” (“used”, “the reference framework used”).
- 13% use a gradual approach (“has embarked upon a process of becoming compliant”, “aims to become compliant with”).

The other practices are heterogeneous but the wordings are unequivocal (“applies”, “follows”, “by referring”, “on the basis of”). However, one company used the verb “drew on”, which lacks clarity as regards the effects it has on the application of the reference framework used.



2. The description of the internal control and risk management frameworks

2.1 Internal control objectives and limits

2.1.1 Using a reference framework for internal control

93% of the companies provide information on the objectives of internal control.

However, these objectives are not always the same as those defined by a standard. Furthermore, when a company chooses to adopt the objectives set out in a standard, it does not always adopt them in their entirety.

41% of the companies refer to the objectives of the AMF reference framework.

2.1.2 The objectives of internal control

2.1.2.1 Reminder

1) The AMF reference framework for internal control

“Internal control is a system set up by the company, defined and implemented under its responsibility, with a view to ensuring that:

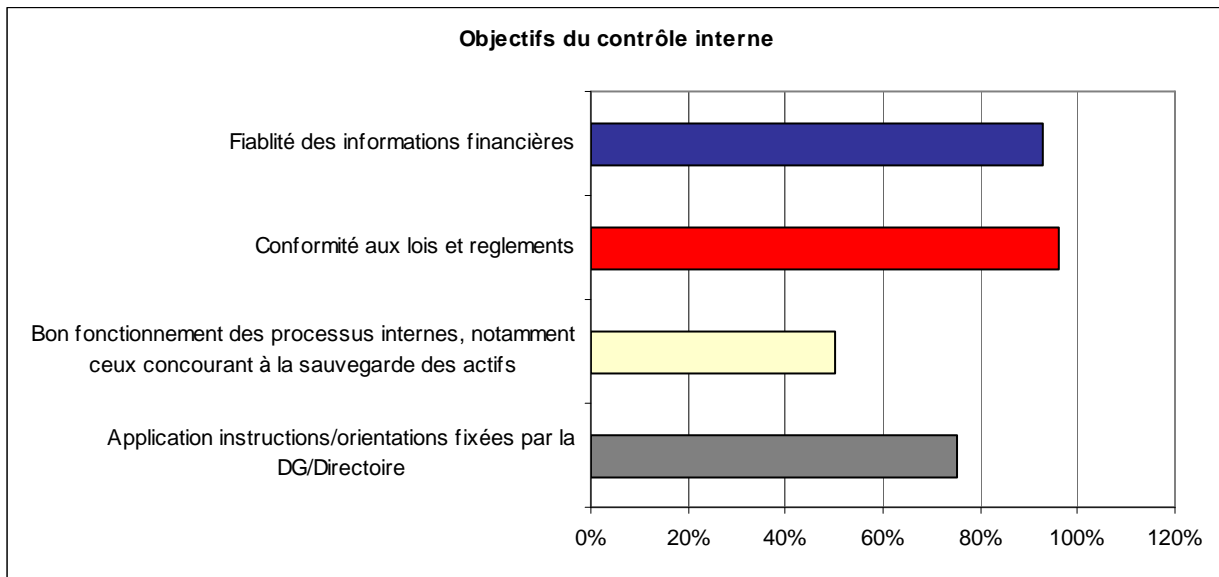
- *laws and regulations are complied with.*
- *the instructions and directional guidelines set by Executive Management or the Management Board are applied.*
- *the company's internal processes are functioning correctly, particularly those implicating the security of its assets.*
- *financial information is reliable (...).”*

2.1.2.2 Findings

Amongst those companies which set out internal control objectives, and whether or not they rely on the AMF reference framework, it bears noting that:

- 95% of the companies look to achieve compliance with laws and regulations.
- 75% of the companies aim to apply the instructions and directional guidelines set by the board of directors or management board.
- 50% of the companies looks to achieve good functioning of the internal processes, particularly those implicating the security of its assets³⁵.
- 93% of the companies aim at achieving reliability of financial information.

³⁵ This percentage takes into account the companies which use the exact terminology of the AMF reference framework and those who use a terminology that is quite similar to that of the reference framework and which aims at the same objective. Four companies which expressly refer to the AMF reference framework did not mention this objective.



The AMF notes that some of the companies which use the AMF reference framework only mention part of its objectives and do not indicate specifically the objective linked to the good functioning of the internal processes guaranteeing the security of the assets. In order to avoid any confusion and for the purpose of consistency, the AMF recommends that companies which use a reference framework recall all the objectives of the said framework and, for this purpose, use the same terminology as that used in the said framework.

2.1.3 The limits of internal control

83% of the companies of the sample specify the limits of internal control.

Amongst them, 92% use standardised terminologies to specify the limits of internal control:

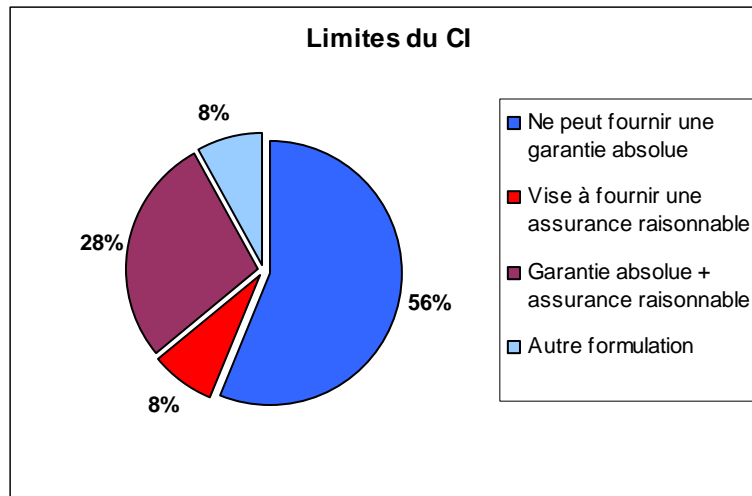
- 61% indicated that internal control “cannot provide absolute protection”³⁶.
- 9% stated that internal control “aims to provide reasonable protection”³⁷.
- 30% used a combination of the two aforementioned wordings.

Besides, two companies used different wordings:

- “(...) As for any internal control system, it cannot eliminate these risks but it aims to prevent their outbreak and reduce their impact”.
- “The internal control system cannot eliminate all the errors, deficiencies or frauds, in particular those resulting from collusion or unidentified shortcomings.”

³⁶ This wording corresponds to that used in the AMF reference framework.

³⁷ This wording corresponds to that used in the COSO framework.



2.2 Using the AMF reference framework

2.2.1 Reminder

1) Organisation of the AMF reference framework

The AMF reference framework identifies five key points:

- the organisation of internal control.
- in-house dissemination of relevant information.
- risk identification.
- the control activities in response to those risks.
- the direction and supervision of the internal control system.

2) The AMF 2009 report

In its 2009 report, the AMF recommended that companies comply with the organisation of the framework to which they refer in their description.

2.2.2 Findings

In practice, the chairman's report does not necessarily follow to the letter the AMF reference framework.

As regards the parts dedicated to internal control and risk management procedures, it should be noted that amongst the companies which rely on the AMF reference framework and, as appropriate, on other complementary frameworks:

- all companies dedicate a paragraph to the organisation of internal control by mentioning the different departments involved in it.
- 60% of the companies dedicate a paragraph to the dissemination of relevant information on internal control and on monitoring internal control.

- all companies dedicate parts to risk management.

Moreover, it should be noted that companies which do not indicate that they relied on the AMF reference framework nevertheless dedicate parts to the organisation of internal control or to the dissemination of key information on internal control and on monitoring internal control.

For the purpose of legibility and comparability of the information disclosed in the reports, the AMF recommends that companies comply with the organisation of the framework to which they refer in their description.

2.3 The link between risks and the risk management procedures

2.3.1 Reminder

1) Commercial Code

Article L.225-37 : “ *The chairman of the board of director reports on the composition, preparation and organisation of the work of the board, as well as on internal control and risk management procedures established by the company, particularly those procedures relating to drawing up and processing accounting and financial information for the company accounts and, where appropriate, the consolidated accounts.*”

2.3.2 Findings

83% of the companies comprising the sample provide information on the risks they are confronted with in the chairman’s report, with an explicit cross reference to another part of the registration document or annual report. Five companies do not provide any information on those risks, neither explicitly nor with a cross reference in the chairman’s report.

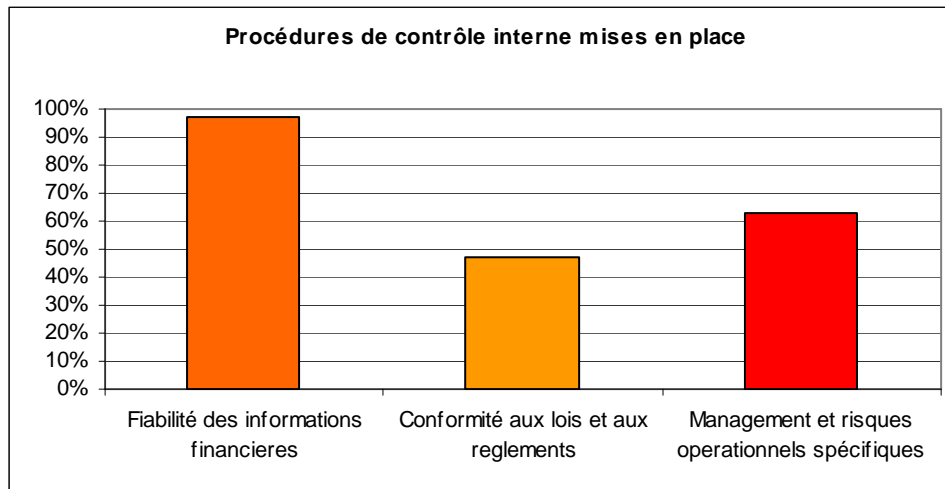
33% of the companies mention the existence of a risk map and 30% of them describe its main characteristics.

Lastly, around two thirds of the companies make a connection between risk identification (often presented in the chapter “risk factors” of the registration document when the company releases such a document) and the risk management procedures, whether risk is managed fully or partially.

2.4 Details of the internal control procedures implemented

As regards the information on the internal control procedures implemented within the company or group, it should be noted that:

- 97% of the companies provided information on the procedures aimed at guaranteeing that financial information is reliable.
- 47% described the procedures aimed at guaranteeing compliance with the applicable laws and regulations.
- 63% mentioned the existence of operational risk management systems.



The AMF recommends that companies make a clear connection between their internal control objectives and the description of the procedures in the chairman's report.

3. The role of the parties involved in internal control

93% of the companies refer to the resources deployed for internal control and risk management:

- 7% of the companies provide an organisational chart of the actors involved.
- 11% have an internal control department.
- 14% have an internal audit department or service.

4. Assessing internal control procedures

4.1 Reminder

In its 2009 report, the AMF recommended in particular that companies describe the steps taken to improve internal control and encouraged them to provide details on the outcome of the assessment they carried out and disclose information on the major failings or shortcomings of internal control. The AMF also called on companies to provide details of the areas for improvement in the context of the ongoing internal control improvement programme

4.2 Findings

4.2.1 The ongoing internal control improvement programme

70% of the companies comprising the sample have embarked in an ongoing internal control improvement programme, although they may not have expressed it explicitly.

Out of these companies, twelve provide information about their 2010 internal control improvement programme. Six companies reveal plans to take action in the medium or long term, though failing to specify whether or not the planned improvements should be implemented as early as 2010. Three companies do not provide any information as regards their internal control improvement programme

4.2.2 Internal control assessment

20% of the companies comprising the sample address the issue of internal control assessment:

- 10% of the companies report that they carried out an evaluation of internal control in 2009. These companies all provide details on the nature of the assessment. Two drafted a self-assessment questionnaire. One company reports that auditors audited the information systems and spotted shortcomings in risk management. The company in question reports that it has committed to take action to tackle this issue.
- another company reports that at least twice a year senior managers identify, assess and treat the major risks faced by the company with the help of external consultants and review the internal control system accordingly. However, it reports that the self-assessment of internal control systems has not been updated insofar as the group's scope of consolidation and business model has remained almost unchanged.
- two other companies report that they are considering assessing their respective internal control system in the financial years to come.

The AMF recommends that companies indicate whether or not they carry out an assessment of internal control and, where appropriate, provide details on the outcome of the assessment. The AMF also recommends that companies provide details on the areas for improvement for their internal control and risk management system.

5. Statutory auditors' report

5.1 Reminder

Article L. 225-235 of the Commercial Code provides that: *"in a report attached to the report referred to in the second paragraph of Article L.225-100, the auditors present their observations on the report referred to in Article L.225-37 or Article L.225-68, as applicable, concerning the internal control and risk management procedures relating to the preparation and processing of accounting and financial information. They also attest to the drawing up of the other information required by Articles L.225-37 and L.225-68"*

5.2 Findings

Virtually all companies of the sample release the auditors' report after the chairman's report.

For the financial year 2009, none of these reports mention caveats, comments, calls for further diligence, warnings of major shortcomings or failings spotted during the preparation of the 2009 chairman's report, nor do they refer to any disclosure on the issue before the publication of this report.

For all companies, the report provides the information required from the chairman, particularly as regards the procedures pertaining to drawing up and processing accounting and financial information.

▪ **ANNEX**

List of the companies comprising the sample:

EURONEXT B (as on 31 December 2009)

ABC ARBITRAGE
ALTEN
LANSON – BCC
GUYENNE ET GASCOGNE
INTER PARFUMS
SELOGER.COM
SYNERGIE

EURONEXT C (as on 31 December 2009)

ACTEOS
AFONE
AKKA TECHNOLOGIES
AUBAY
AUSY
AVENIR TELECOM
EGIDE
ESI GROUP
GROUPE CRIT
GROUPE GORGE
GUILLEMOT CORPORATION
HF COMPANY
HIGHCO
INFOTEL
MODELABS GROUP
PAREF
P.C.A.S.
PHARMAGEST INTERACTIVE
SOGCLAIR
TEAM PARTNERS GROUP
THERMADOR GROUPE
TOUPARGEL GROUPE
VIVALIS