October 2017

High Committee for Corporate Governance Annual Report

HCGE

Haut Comité de Gouvernement d'Entreprise

This document is an unofficial English translation of Part One of the 2017 annual report of the Haut Comité de Gouvernement d'Entreprise *(High Committee for Corporate Governance), a body set up by French business associations Afep and Medef to monitor the implementation of the Afep-Medef Corporate Governance Code for Listed Companies. It does not include Part Two of the original report, which is a detailed analysis based on the monitoring of the annual reports/reference documents of SBF 120 index companies.*

Contents

Preface

This fourth annual report of the High Committee for Corporate Governance covering the period from September 2016 to September 2017 reflects the many transformations relating to its activity and the context in which it operates.

Indeed, as in many other spheres, corporate governance rules and practices in France have seen significant changes.

The November 2016 version of the Afep-Medef code, to which the High Committee contributed, marked a new milestone in the improvement of companies' governance practices. By imposing binding *ex-ante* and *ex-post* voting on compensation, the so-called Sapin 2 Law of 9 December 2016 naturally prompted the High Committee to review its role regarding executive compensation in this new legal framework, as is the case every time that legislators incorporate some of the Code's recommendations into law.

The High Committee is of the opinion that these developments do not call into question its action with regard to corporate governance and the development of good practices in this sphere. Its role goes beyond being the guardian of the Afep-Medef code – good governance of listed companies also contributes to the competitiveness of French undertakings and of France itself.

The High Committee operates in two main ways: the High Committee provides those companies which refer to the Code with guidance regarding the correct implementation of its provisions, and it intervenes through its "investigations" to point out to them the most significant non-compliances if these are not the subject of an explanation that is "*comprehensible, relevant and detailed*", as recommended by the Code. It also has the task of "*proposing amendments to the Code in the light of changing practices, including at the international level, the recommendations or areas of consideration addressed by the AMF or also the requests of investors*".

In accordance with the communication policy outlined in its previous reports, it reserves the right to publish the names of companies which have not complied with the Code's rule whereby "if a company decides not to follow the recommendations of the High Committee, it must mention in its annual report the latter's opinion and the reasons why it has decided not to comply with these recommendations". For the first time, the High Committee has been compelled to implement this provision in this report.

However, the main finding once again this year is that there has been an improvement in compliance by large French companies with the Afep-Medef code and, beyond the formal aspects of this compliance, in governance practices. The High Committee's recommendations have been largely followed.

Finally, the past year saw significant changes in the membership of the High Committee, which is keen to ensure the smooth renewal of its members, as should also be the case for the boards of directors for which it operates. Consequently, it welcomed two new members, Michel de Rosen and Ross McInnes, as replacements for Françoise Gri and Pascal Colombani, to whom it would like to pay tribute for their contributions. In the same spirit of smooth renewal, following Denis Ranque's decision not to seek the renewal of his mandate, Michel Rollier, who has played an active role in the High Committee's work since it was established in 2013, was made chairman of the High Committee.

Denis Ranque Michel Rollier

1. High Committee's activities in 2016-2017

1.1. Meetings and external contacts

It should be remembered that the High Committee, which was set up in 2013, consists of four experts who either hold or have held executive positions in international groups (including the Chairman) as well as three qualified individuals representing investors and/or chosen for their legal or ethical expertise. These individuals are appointed for a period of three years, which may be renewed once based on a mechanism of staggered terms of office.

The High Committee met 10 times between September 2016 and September 2017, with an attendance rate among its members of 89%. Between the meetings, e-mail exchanges and conference calls took place as required.

The Chairman attended a meeting held in London in June 2017 with the chairmen of the committees responsible for supervising the corporate governance codes in Germany, Great Britain, Italy and the Netherlands. A press release appended in Annex 4 summarises the conclusions of this meeting.

Furthermore, the Chairman gave an interview to the newspaper Les Echos at the time when the 2016 Activity Report was published, and the general secretary took part in various conferences and seminars on corporate governance themes. Meetings took place with the Japanese government's *benchmarking* mission entrusted to the firm Deloitte and with the Turkish *Capital Market Board*. The High Committee was consulted by three university teams conducting research in the framework of the Ministry of Justice's "Law and Justice" mission[1].

Finally, while respecting the mutual confidentiality of their contacts with companies and their mutual independence, the High Committee and the French Financial Markets Authority maintained informal contacts to discuss and find out their respective positions.

1.2. Consultations by companies

Various requests for interpretation of the Afep-Medef code were sent to the High Committee, either formally by boards of directors or supervisory boards, or directly to its general secretary or through the legal departments of Afep and Medef.

These questions, for the most part informal, notably concerned the 12-year rule for directors' independence, pension schemes and justification for compensation decisions.

- [1] A study entitled "What legal framework for effective implementation of corporate governance codes?" conducted by the Centre for Critical Legal Research (CERCRID) of Jean Monnet University, Saint-Etienne and the Louis Josserand Research Team of Jean Moulin University (Lyon 3) under the leadership of Mrs Emmanuelle Mazuyer;
- a study entitled "Value of corporate governance and governance of corporate values, research into the effects of governance codes", conducted by the Applied Research Team in Private Law of the Legal Rights and Perspectives Research Centre (CRDP) of the University of Lille 2 under the leadership of Mr Jean-Christophe Duhamel;
- and a study entitled "The effectiveness of governance codes, compared and multi-disciplinary perspectives" conducted by the Centre for Civil Law of Business and Economic Disputes (CEDCACE) and the Institute for Research into Business and Professional Relations (IRERP) of Paris X Nanterre University under the leadership of Mmes Katrin Deckert, Tatiana Sachs and Sophie Upond.

Only the first of these studies has been published at this stage, in April 2017.

1.3. Initiatives undertaken by the High Committee

During the financial year 2016-2017, the High Committee sent around 30 letters at its own initiative to the chairmen of various companies, in particular:

- coinciding with the publication of information about the compensation awarded to executive directors; following the publication of the annual reports for 2016, in July 2017 to SBF 120 companies in order to point out to them deviations from the Code or inadequate explanations, or to draw their attention to points that it considers important. The themes addressed in these letters are detailed in point 2 below.
- on an ad hoc basis during the year, to point out proven significant shortcomings which may have come to the High Committee's attention.

Furthermore, the High Committee notes that since December 2016, an important matter addressed by the Afep-Medef code, and which the High Committee used to monitor, is now governed by the law. This concerns the advisory *say on pay*, which has been replaced by a binding dual mechanism, *ex-ante* as from the general meetings in 2017 and *ex-post* as from the meetings in 2018, in accordance with the provisions of the Sapin 2 Law. The situation was similar in 2011 for the provisions of the Copé-Zimmermann Law, which included the Code's provisions regarding the presence of women on boards and laid down that companies should comply with the proportion of 40% as from the general meetings in 2017. The High Committee discussed this development, which could result in its sphere of competence being reduced. However, the High Committee's name refers to "corporate governance" and not just to the Afep-Medef code, and the High Committee was of the opinion that, given the interaction and close links between the two registers, the law and the Code, it could legitimately intervene in these spheres if required.

The implementation of this position by the High Committee more specifically regarding compensation is specified in point 3 below.

Finally, the High Committee reviewed the reports of non-SBF 120 companies referring to the AFEP-MEDEF Code (cf. § 2.15 p. 16 below).

1.4. Reminder of the High Committee's external communication rules

The responses to the companies' consultations as well as the opinions expressed at its own initiative, in particular following the systematic review of the annual reports by the High Committee, are sent to the chairmen of the boards (or committees) on a confidential basis. As it has stated on a number of occasions, it considers this confidentiality to be a necessary condition in order for its preventive role to be effective. The companies which receive opinions from the High Committee are free to report on them, in particular in order to indicate that the decisions taken by their boards comply with these opinions.

Nevertheless, in certain exceptional cases, the High Committee may issue communications regarding its interventions; however, such communications do not concern the detailed content of its opinions.

Finally, it is pointed out that in accordance with § 27.2 of the Code, "*if a company decides not to follow the recommendations of the High Committee, it must indicate the latter's opinion in its annual report together with the reasons why it has decided not to comply with these recommendations*". The High Committee has indicated on a number of occasions that, otherwise, it reserves the right to communicate regarding this situation.

This year, the High Committee identified several cases where its comments from previous years had not been taken into account in the 2016 annual reports. It pointed these out to the chairmen of the companies in question, reminding them that if they did not formally undertake to comply or provide an appropriate explanation, the High Committee would be obliged to mention their names in its own annual report.

In this context, the High Committee has been prompted, in these few cases, to name the companies which, despite letters from the High Committee, have persisted, on the one hand, in deviating from significant recommendations of the Code and, on the other hand, have not acted on the High Committee's opinions or mentioned in their annual report the reasons why they may have decided not to act on them, nor undertaken to rectify this situation.

The High Committee has also been particularly vigilant regarding the quality and accuracy of the information relating to its action featured in the companies' communication.

Consequently, the High Committee was prompted to intervene in one case where a company requested a consultation concerning extraordinary compensation. The High Committee stated that it was compatible in principle with the provisions of the Afep-Medef code but recommended, in particular, that it be limited to the maximum applicable to severance payments since it was stated that this departure would follow the performance of the operation determining the payment, a recommendation which the company followed. The company communicated regarding this point, mentioning that the High Committee had given its approval. The High Committee is keen to explain that it was not an "approval" and that its analysis concerned neither the appropriateness of the extraordinary compensation nor its amount.

2. Main topics addressed by the High Committee in its consultations and investigations in 2016-2017

As in previous years, across the entire scope, the recommendations set out in the letters have almost all been followed by the companies. Furthermore, the latter increasingly refer to the opinions received from the High Committee in the explanations they give regarding certain aspects of governance in their annual reports.

The High Committee set its priorities in 2017 in this context, notably reviewing the recommendations of the Code where the compliance rate is still inadequate.

Particular attention was paid to the situation of "repeat offender" companies not taking into account the High Committee's letters and recommendations sent previously. Where applicable, these repeated deviations are mentioned in this report.

The following themes were selected:

2.1. Form of organisation of governance

For the financial year 2016, with regard to the choice of companies with a board of directors between separation of the offices of chairman and chief executive officer and the aggregation of such duties, a slight drop in the unified form of management was observed (51% compared with 52.4% in 2015 for the SBF 120, and 58.8% compared with 60% in 2015 for the CAC 40), while a change in the form of management took place in 2016 in more than 10% of the companies (SBF 120 10.6% and CAC 40 11.8%).

The High Committee continues to be vigilant with regard to the implementation of the recommendation of the Code (§ 2.2) stating that "*when the Board opts for separation of the offices of Chairman and Chief Executive Officer, if appropriate any tasks entrusted to the Chairman of the Board of Directors in addition to those conferred upon him or her by law must be described*". Most of the companies, with a few exceptions such as the company WORLDLINE, explain the motivation for their choice regarding the form of governance (see Part 2, § 1.1, p.28).

This provision naturally concerns companies with a board of directors, but it is also mentioned (in the preamble of the Code) that public limited companies with a management board and supervisory board must "*make adjustments as appropriate*" to apply the recommendations. This prompted the High Committee to review the appropriateness of the description of the duties of the chairman of the supervisory board of VIVENDI according to this company's annual report, and the reality of these duties as shown in the report on the operations carried out by the group. Following a process of dialogue with the company, the High Committee noted that the latter undertook to describe these duties and to improve its communication with regard to this point.

2.2. Independent lead director

The High Committee carefully reviewed the implementation of the Code's new recommendation relating to the independence of the lead director. It appears that within companies with a lead director, the latter is described as independent in 93.7% of cases. The Committee reviewed the explanations given in the few exceptional cases observed of a non-independent lead director.

2.3. Participation of employee directors on the board and on the compensation committee

The law on social dialogue and employment of 17 August 2015 (so-called Rebsamen Law) has broadened the range of companies affected by the obligation to appoint one or more employee directors, but its deadlines for entry into force mean that it will only be fully applicable in 2018 for some companies. An assessment of the compliance of these companies with the provision of the Code (see Part 2, § 4.2 p.61) is therefore still only of limited significance.

The participation of employees on the board of directors has increased, particularly for boards of directors with both directors appointed by employees but also representing employee shareholders, and especially within the CAC 40, with a percentage of 76.5% in 2017 compared with 64.8% in 2016. This trend is set to continue given the gradual implementation of the aforementioned law (see Part 2, § 3.6 p.46).

With regard to the recommendation to appoint an employee director to the compensation committee, the High Committee has identified several companies which have boards with one or more employee directors but which have not yet appointed any to their compensation committee as recommended by § 17.1 of the Code (17 SBF 120 companies including six belonging to the CAC 40). These companies generally provide an explanation about this, most of the time to indicate that they plan to do so shortly. Very few fail to mention this matter, and the High Committee has contacted them as the presence of employee directors has increased. However, the High Committee has noted a significant rise regarding this aspect since there is an employee on the compensation committee in 65% of the SBF 120 companies in 2016 compared with 55.5% in 2015. This trend is also confirmed for the CAC 40, with 75% participation in 2016 compared with 69.6% in 2015.

2.4. Proportions of independent directors on the board and on committees

The High Committee had already noted that the proportions of independent directors recommended by the Code for committees (2/3 on the audit committee, majority on the compensation and selection committees) seem to be more difficult to comply with than the proportions of independent directors on the board itself (see 2016 Activity Report, p. 12). This trend is continuing (see Part 2, § 3.2 p.37, § 4.1 p.57**Erreur ! Signet non défini.**, § 4.2 p.61 and § 4.3 p.64), with a fall in this proportion on audit committees from 83.8% for 2015 to 81.7% within the SBF 120, and from 88.7% to 88.2% within the CAC 40. This situation is no doubt due to constraints regarding the expertise and availability of directors. Regarding this point, the High Committee would like to point out that it would prefer the proportions to be not quite satisfied rather than see the criteria for independence interpreted too freely (for example by deviating from the one regarding being on the board for 12 years), and that it is of the opinion that 60% of independent members on the audit committee or 50% on the other two committees does not constitute a serious deviation.

The High Committee has already had occasion to indicate that the presence of a reference shareholder is not sufficient to explain the deviation (as the company SARTORIUS STEDIM BIOTECH does, for example) since, on the contrary, this underlines the value of independent directors in the supervisory functions that the committees facilitate (see 2016 Activity Report, p. 12). Without exception, all of the companies which do not comply with these proportions indicate this and provide a justification, often related to the composition of their shareholding structure. Companies must nevertheless keep up their efforts to achieve the required proportions, in particular when renewing directors' terms of office.

2.5. Assessment criteria for "significant business relationships"

In 2016 (see 2016 Activity Report, p. 13), the High Committee pointed out the importance of specifying in the annual report the criteria defined by the board of directors or supervisory board for assessing the significant or non-significant nature of the business relationships with the company that its board members liable to be considered independent may have. Due to the wide range of situations, it does not in fact seem desirable for the Code to set out quantitative criteria. The issue of business relationships now seems to be addressed by almost all of the boards. However, like the previous year, significant business relationships are sometimes simply mentioned in a list of the criteria of the Afep-Medef code, or indeed by pointing out the board's obligation to define and explain the criteria, but without any explanation of the criteria. However, this year has seen a positive shift, since specifying the criteria for significant business relationships rose from 67% to 70.6% in 2016 for the SBF 120, and from 83.9% to 84.8% in 2016 for the CAC 40.

As in previous years, the High Committee considers that this is an important and sensitive matter where there is room for improvement.

The High Committee pointed out in a letter sent to some of the companies in the sample the importance of mentioning in the annual report the criteria used, but some companies (INNATE PHARMA, NEXITY, SARTORIUS STEDIM BIOTECH, SFR GROUP and WORLDLINE) are continuing to provide no information about the assessment of the significance of the business relationships, without acting on the letters from the High Committee.

2.6. Individual evaluation of directors' contribution to the work of the board

The High Committee would like to draw the attention of the companies to an aspect mentioned in § 9.2 of the Afep-Medef code in relation to the evaluation of the board of directors, where it is specified that one of the three objectives sought by the annual evaluation of the board of directors is "*to measure the actual contribution of each director to the Board's work".*

This year, Part 2 of this report features an analysis of the implementation of this provision by the SBF 120 companies (see Part 2, § 3.10 p.51). The compliance rate found is still relatively low, with 61 of the SBF 120 companies and 26 of the CAC companies applying this recommendation. However, it seems that this practice is growing despite the fact that the High Committee only highlighted this point in 2016.

Firstly, a distinction needs to be made between the actual implementation of this practice and it being communicated by the companies in their annual reports. It is certainly true that the practice itself is less widespread in France than in the UK or Scandinavia, for example. This is no doubt due to the fact that it is not part of the country's culture. Some companies which explicitly deviate from this provision of the Code mention the fact that it could damage the board's spirit of collegiality, and we understand how some directors are hesitant to criticise their peers officially. Moreover, it may seem difficult to measure each person's contribution objectively.

Nevertheless, the High Committee is of the opinion that the actual implementation of this provision of the Code is essential in order to guide the nominations committee in its proposals for renewals or successions within the board, which should enable a better balance to be ensured in its membership (§ 6.1 of the Code). It also corresponds to growing demand from shareholders, who are keener that the skill, complementarity and independence of the directors they appoint should be demonstrated. It is also valuable for constantly improving the functioning of the board, provided it results in individual feedback by the chairman of the financial year's results: in fact, it must be possible for each director to be informed of the perception their colleagues have of their involvement in the board's work in order to be able to improve on certain points where necessary. It is desirable for this feedback to be given by the chairman or lead director. The chairman, who plays an important role in the smooth functioning of the board, must also submit to this evaluation himself.

Furthermore, the annual reports do not always provide information about this matter, nor incidentally about the "steps taken as a result" as recommended by § 9.3 of the Code (see Part 2, § 3.10 p.51). Too often, they satisfy themselves with reproducing the wording of the Code in the details relating to the internal rules of the board.

Experience shows that it is entirely possible to insert the elements needed for a satisfactory individual assessment into the board's formal evaluation questionnaires. The account given of this in the annual report should not, of course, give individual details, but it is important for shareholders to be informed that the exercise has taken place.

Finally, the comments of the officers and directors of the companies which have seriously implemented the process, as well as those of the specialist consultants assisting them, are extremely positive regarding the sincerity and value of the responses collected.

2.7. Practice of holding meetings without executives being present

The implementation of the recommendation to hold a meeting of the board of directors each year without the executive officers being present is gradually becoming a widespread practice.

In its 2016 Activity Report, the High Committee pointed out that a relatively high number of companies was still not mentioning this practice or was deviating from it.

However, 2016 saw progress on this topic within the SBF 120 with 60.6% of the companies having arranged a meeting for the non-executive directors only compared with 57.1% in 2015, and a stronger trend within the CAC 40 with 76.5% compared with 68.6% in 2015.

The High Committee would like to point out:

- that it has been asked whether directors representing employees may or may not take part in these meetings. It is of the opinion that it is the responsibility of each board to specify the rules governing this point, according to how these meetings are organised and the topics they address;
- that even though it is not explicitly set out in the Code, the High Committee considers that its application to companies with a management board and supervisory board, that is to say a meeting of the latter without the management board being present (see 2016 Activity Report, p. 13), should be implemented under the same conditions;
- similarly, it considers that this practice is not in principle incompatible with partnership limited by shares status, indeed some of these companies have no difficulty implementing it.

Some companies in the sample (INNATE PHARMA, SARTORIUS STEDIM BIOTECH, SFR GROUP and WORLDLINE) give no information or explanation about the implementation of this practice, despite a formal request by the High Committee.

2.8. Option for committees to call upon external consultants

In its contacts with certain companies, the High Committee pointed out § 14.3 of the Code, according to which "*the committees of the Board may request external technical studies relating to matters within their competence, at the corporation's expense, after informing the Chairman of the Board of Directors or the Board of Directors itself, and subject to reporting back to the Board thereon. If committees have recourse to services provided by external consultants (e.g. a compensation consultant in order to obtain information on compensation systems and levels applicable in the main markets), the committees must ensure that the consultant concerned is objective".*

The purpose of the reminder of these provisions is to highlight the importance of the committees' work upstream of the board of directors' decisions. The committees often need to carry out extremely in-depth work and studies on technical matters requiring outside illumination where applicable. This point is also important to enable the board to have independent advice available.

2.9. Succession planning for executive directors

Succession planning for executive directors is one of the priority topics on which the High Committee has decided to focus its analysis of the registration documents (see its Annual Report 2016, p. 11). In fact, § 16.2.2 of the Code states that "*the selection or nominations committee (or an ad hoc committee) must implement succession planning for executive directors in order to be in a position to propose succession solutions to the Board, particularly in the event of unforeseeable vacancy. This is one of the committee's most important tasks even though it can be, if necessary, entrusted to an ad hoc committee by the Board*".

This point has still not been fully addressed. Many companies indicate that succession planning is one of the tasks of the selection or nominations committee, but do not mention this process in the report of its work. It is often indicated that the nominations committee has considered the evolution of the membership of the board itself, but without specifying the existence of succession planning for executive directors.

However, significant progress was observed in 2016, since 71.8% of the SBF 120 companies mentioned establishing or following a succession plan compared with 53.3% in 2015. Progress was also high for the CAC 40, as 85.3% of the companies mentioned this point compared with 77.1% in 2015.

While acknowledging that this is a tricky matter, the High Committee would like to stress, as it did in 2016, that it is important for companies to prepare not only for the untimely departure or loss of the principal officer but also for "foreseeable" departures, in particular due to age restrictions. It is highly desirable that succession planning should take place systematically from the start of the director's term of office and be updated subsequently, which avoids questions about why the board should choose to address this matter at a given time during the term of office. It is also important to inform shareholders that this process has indeed been carried out, without it being necessary, of course, for the results to be published.

The High Committee contacted a number of companies in the sample to remind them of this recommendation, but it has to be said that some of them (INNATE PHARMA, NEXITY, SARTORIUS STEDIM BIOTECH, SFR GROUP and WORLDLINE) gave no explanation about their lack of communication regarding this point.

2.10. Presence of the chief executive officer on the nominations committee

The High Committee reminded certain companies of the provisions of the Code (§ 16.3) concerning the mode of operation of the nominations committee, which state that "*the Chief Executive Officer contributes to the work of the nominations committee. If the functions of Chairman and Chief Executive Officer are separated, the non-executive Chairman can be a member of this committee".* A note relating to this provision specifies that "*this recommendation applies to the Chairman and Chief Executive Officer or Chief Executive Officer in corporations with Boards of Directors, the Chairman of the Management Board, the sole Managing Director of a public limited company with Supervisory Board and to the statutory managers of partnerships limited by shares*".

The High Committee is of the opinion that this point should not be overlooked and is fully committed to the generally observed improvement in the processes for selecting directors.

2.11. Significant variable part in the calculation of directors' compensation, related to regular attendance

The High Committee observed that the number of companies having put in place rules for the award of directors' compensation including a significant variable part as recommended in § 20.1 of the Code is almost stable for the SBF 120 (82.7% in 2016 compared with 82.9% in 2015) and for the CAC 40 (88.2% in 2016 compared with 91.4% in 2015). The importance of this recommendation was pointed out to the companies concerned.

2.12. Compensation of non-executive chairmen

The High Committee assured itself of the implementation of the new recommendation of the Code that advises against the award of variable compensation, stock options or performance shares and states that, if such awards are granted, the board must justify the reasons for this (§ 24.2). The situation is satisfactory and only one deviation, accompanied by a highly specific explanation, was identified.

2.13. Degree of achievement of performance determining the variable part of the compensation

With regard to the detailed presentation of the rules governing the award of the annual and multi-annual variable parts, some companies cite reasons of confidentiality for deviating from the recommendation of § 25.2 of the Code which notably stipulates it, for example the company SFR GROUP. While the Code stipulates not "*jeopardising the confidentiality that may be linked to certain elements in the determination of the variable part of the compensation*", it is observed that other companies, operating in equally competitive markets, provide their shareholders with relatively detailed information regarding this point. Some examples of good practices can be found in Part 2 of this report (see Part 2, § 8.2 p.75).

2.14. Sub-ceiling for the award of stock options or performance shares to executive directors

Specifically presenting policies for the award of options or shares to executive directors is becoming widespread. Very few companies (three in the SBF 120) did not comply with the recommendations of § 25.2 of the Code (see Part 2, § 8.3 p.80), and the High Committee contacted them to remind them of this.

2.15. Review of companies declaring full compliance with the Code yet for which significant deviations are identified

The High Committee reviewed in detail the annual reports of companies which declared that they were fully compliant with the provisions of the Code without any exception (see Part 2, § 6 p.69). The Code states that "*companies must indicate in a specific section or table the recommendations that they have not implemented and the respective explanations*". Strictly implementing this rule is the cornerstone of the system on which the "comply or explain" rule is built, and it is very important that this rule is strictly applied and that the companies, where necessary, provide an explanation when they deviate from one or more provisions.

The High Committee consequently systematically contacted those companies which declared that they were in full compliance with the Code's recommendations when, in reality, they had omitted certain deviations, in order to remind them of the rules of the Code, and will continue to be vigilant regarding this point.

2.16. Investigation beyond the SBF 120

As before, the High Committee took an interest in non-SBF 120 companies referring to the AFEP-MEDEF Code.

A brief review was carried out of the annual reports (2015 or 2015-2016) of certain companies referring to the Afep-Medef code but not included in the sample covered by Part 2 of this report, i.e. the SBF 120 index. These are companies on the Euronext CAC All-Tradable (formerly SBF 250) index, with the

High Committee selecting the market capitalisation threshold of €200 million this time. The composition of this index, which comprises 310 companies, undergoes significant variations from one year to the next. The number of non-SBF 120 companies exceeding the threshold selected by the High Committee is 83, of which 36 refer to the Afep-Medef code and 44 to the Middlenext Code. Three companies state that they do not refer to any corporate governance code, which the law permits provided an explanation is given for this decision and the rules adopted in addition to the law (Art. L.225-37 and L. 225-68 of the Commercial Code) are indicated.

This analysis was mainly based on the following criteria: proportion of independent directors on the board and on the committees, number of other directorships held by the chief executive officer and presentation of a reasonably specific *say on pay* resolution to the general meeting.

It can be seen that controlled companies make up the overwhelming majority of this sample. Only five out of the 36 selected are not, though they still have a reference shareholder (or several acting in concert) with around 30%. With regard to executive compensation, the levels of which are, as might be expected, lower overall than within the SBF 120 companies (although with a very wide range within the sample), the average approval rate for the *say on pay* resolutions in 2016, at 88.2%, is very close to that observed for the SBF 120. Furthermore, it is confirmed that there is extremely broad compliance with the rule of the Code concerning concurrent directorships, at least for the executive directors.

The High Committee wrote to four companies in the sample to point out to them shortcomings concerning, in particular, the proportion of independent directors on the board and on committees, and the information submitted in support of the *say on pay* resolution (or, in one case, the absence of such a resolution). It suggested to them that they should review the suitability of referring to the Middlenext Code. The same suggestion was made to six companies in 2016: two of them did so, another decided not to refer to any code as the law permits, another improved the presentation of its annual report and two others have since been delisted.

3. Reflections and work on governance themes in development

3.1. Review of "say on pay" general meeting resolutions (provisions of the Code)

In Spring 2017, the High Committee carried out a review of the opinions of the SBF 120 general meetings regarding *say on pay* resolutions and regarding the sub-ceiling for the award of stock options and performance shares to executive officers laid down in § 23.3.3 of the Code. This review showed that all of the companies in the sample presented advisory opinion resolutions regarding the compensation of their executive directors in accordance with the Code (as well as, with one exception, resolutions for the ex-ante approval of the principles and criteria for the 2017 compensation in accordance with the Sapin 2 law). Only three companies referred to extremely brief or inaccurate indications. With regard to the sub-ceiling in resolutions authorising the issue of options or performance shares, there were very few resolutions of this type this year, since a lot of companies had submitted them in 2016 in response to the Macron Law, and only two companies omitted to specify this sub-ceiling.

Even though the arrangements for the approval of executive compensation are now covered by legal provisions, the High Committee is of the opinion that it is still its duty to monitor this topic closely related to the implementation of the Code.

The average approval rate of the advisory resolutions at the 2017 general meetings of the SBF 120 companies stands at 87.05% compared with 87.74% in 2016, and for the CAC 40 it stands at 83.38% in 2017 compared with 88.59% in 2016, which does not call for any specific remark except to note a slight drop in the approval rate between 2016 and 2017. More significant is the number of companies which obtained a relatively low "score". Some observers consider that a rate lower than 70%, or others a rate lower than 80%, should be a source of concern for the board. It can be seen that 22 companies in the sample obtained less than 75% of votes in favour of one of these resolutions (*ex-post* and/or *ex-ante*) in 2017 for the principal officer, compared with 15 in 2016. This significant increase reflects the attention paid to these topics by shareholders.

At the general meetings in 2017, one *say on pay* resolution was rejected: this was a resolution relating to the compensation of the chairman and chief executive officer of ELIOR (36.89%) at the general meeting on 10 March 2017. The High Committee is surprised at the lack of communication to date relating to this from the board of directors of Elior. By way of reminder, § 26.2 of the Code states that "*if the ordinary shareholders' meeting issues a negative opinion, the Board must meet within a reasonable period and examine the reasons for this vote and the expectations expressed by the shareholders. Following this consultation and on the recommendations of the compensation committee, the Board will rule on the modifications to be made to the compensation due or awarded in respect of the closed financial year or the future compensation policy. It must then immediately publish information on the company's website indicating how it has responded to the vote at the shareholders' meeting and report on this at the next shareholders' meeting.* "

The High Committee formally reminded this company of this provision of the Code and considers that the failure to act on its letter and the lack of communication from the board, more than six months after the general meeting, regarding an important and publicised topic, is a serious deviation.

3.2. High Committee's position in the new legal framework applicable to executive compensation

The law of 9 December 2016, known as the Sapin 2 law, dramatically changed the legal framework by imposing binding *ex-ante* and *ex-post* voting for all listed companies.

This year, in the light of this new legal context, the High Committee reviewed its role with regard to compensation. The High Committee has thus far devoted a significant proportion of its interventions, either in response to consultations or in relation to investigations, to executive compensation matters. Monitoring the implementation of the governance rules relating to compensation has in fact, more perhaps than in other countries' corporate governance codes, been a key objective of the Afep-Medef code since 2008. This was particularly true after the introduction of the advisory *say on pay* in the 2013 version of the Code, which coincided with the establishment of the High Committee itself.

The High Committee has delivered consultations on this topic, mainly at the start of its period of activity, and made interventions both in the context of its annual review of the annual reports of the SBF 120 companies and coinciding with specific publications issued by companies, some of which have attracted press attention. Most importantly, it has published a "doctrine" based largely on interpretations of the Code in its annual reports since 2014 and in successive versions of its application guide.

The advisory resolution regarding the compensation of the chairman and chief executive officer of Renault received a no vote at the general meeting on 29 April 2016, immediately followed by a press release from the board of directors stating that it would not alter this compensation for the financial year 2015 and that it would task the compensation committee with "looking into the changes needed to the compensation structure for 2016 and subsequent years". As laid down in the Afep-Medef code, the High Committee investigated this matter and sent the chairmen of the board and of the

compensation committee an initial letter containing recommendations. Keen to preserve the confidentiality of its opinions, the High Committee deeply regrets that this letter was communicated to the press. It subsequently entered into a dialogue with the representatives of the board and issued new recommendations for setting compensation in the years to come, particularly concerning the need for significant adaptations and more comprehensive communication explaining the arrangements for taking into account the compensation paid by Nissan. In accordance with its communication policy (see § 1-4 p. 9 above), the High Committee would like to point out that these recommendations have only been followed in part.

In any event, the introduction of binding double voting now gives shareholders a considerable amount of power. The law itself only gives indications about the necessarily exhaustive nature of the presentation of the compensation elements to be voted on by shareholders. Incidentally, the elements which have to be provided differ only slightly from those which previously had to appear in the management report according to Article L. 225-102-1 of the Commercial Code, detailed gradually through a succession of legislative reforms since 2001. The implementing decree of 16 March 2017 makes several further clarifications regarding the nature of the indications which have to be given. Furthermore, the wording of the law contains several inconsistencies (for example, application of the *say on pay* to members of supervisory boards but not to members of boards of directors) and leaves some uncertainties, notably concerning the situation for new executives from outside.

As for the expected effect that the law will have on compensation levels, it should be pointed out that 14.7% of the CAC 40 companies and 38.5% of the SBF 120 companies are controlled (see Part 2, § 3.2, p.37). Beneath these, the brief review of the CAC All-Tradable index companies (see § 1-3 p. 9 above) suggests that this is the case for most French listed companies. Moreover, observers agree that this new system will increase the influence of large institutional investors and *proxy advisors*, and that the setting of compensation will largely depend on the dialogue – and indeed negotiation – with these two categories of stakeholder.

The points of view of shareholders are by nature extremely diverse, just as they themselves are: individual shareholders, asset managers, pension funds, hedge funds, State, etc. Some institutional investors attach growing importance to sustainable development considerations and the long-term interests of the undertaking, and this is reflected in their more open attitude towards extra-financial criteria when it comes to setting the variable part of the compensation. This is not the case across the board, for example bear in mind that the "*pay for performance*" voting policy of the proxy voting agency ISS, which is extremely influential among foreign shareholders, favours the criterion of "*total shareholder return*" (TSR) in its recommendations. Furthermore, the State is still a major shareholder in listed companies in France and pursues public policy objectives with regard to executive compensation.

It therefore seems necessary for the Afep-Medef code to continue to present demanding broad principles for determining executive compensation as featured in § 24 of the Code, mainly oriented towards the interests of the company and of all the stakeholders, as well as the terms for implementing these principles. The High Committee is therefore of the opinion that its role to interpret the Code in both its forms – consultation and investigation – is still relevant.

3.3. Proportion of women on boards of directors and supervisory boards

By way of reminder, the AFEP-MEDEF Code has stated since 2010 that "*with regard to the representation of men and women, the aim is for each board to achieve and then to maintain a percentage of at least 20% women within three years and at least 40% women within six years*". This latter proportion should therefore be achieved by the end of the 2016 general meeting.

The law has addressed this issue, and the same male/female parity quotas on boards of directors and supervisory boards were introduced by the law of 27 January 2011 (Copé-Zimmermann law) with a time lag of one year. The scope of the law goes well beyond the listed companies referring to the Afep-Medef code, since all companies employing more than 500 employees and with a balance sheet total or turnover of more than 50 million euros were concerned initially. The workforce threshold was subsequently lowered to 250 employees.

There was no longer any reason for the corresponding provision to feature in the Afep-Medef code, so it has been removed. Nevertheless, the High Committee wanted to observe its implementation in the sample of companies to which this report refers.

The trend in the composition of the boards in companies referring to the Afep-Medef code is satisfactory, since the average proportion of women is 43.6% for the SBF 120 companies and 44.1% for the CAC 40 companies analysed by this report (see Part 2, § 3.5 p.45) at the end of the 2017 general meeting[2]. Following the 2017 general meetings, the 40% lower limit is complied with by 98% of the SBF 120 companies and by 100% of the CAC 40 companies.

The recommendations of the High Committee, which had written to certain companies in 2016 on this matter to remind them that it was imperative to comply with the quota the following year, have therefore been listened to.

The High Committee is of the opinion that there is considerable room for improvement in terms of developing committees chaired by women. The High Committee also found that the membership of the executive or management committees within the CAC 40 reveals a very low proportion of women (14% on average in 2016). The High Committee is of the opinion that it is not its role to investigate this matter so to speak, and that the statistics are not very significant given the diversity of the membership of these committees (from five to 29 members in the CAC 40 companies). Nevertheless, it would point out that diversity in the membership of boards of directors and supervisory boards is one of the principles of the Code, and that executive committees are the main "pools" from which directors are recruited. The High Committee also notes that there is room for progress in terms of the proportion of committees chaired by women, particularly for audit committees. For the CAC in June 2017: 33% of audit committees chaired by women, 27% of compensation committees, 41% of nominations committees and 39% of nominations and compensation committees combined (Source: Spencer Stuart).

3.4. Separation of the offices of chairman and chief executive officer

The November 2016 version of the Afep-Medef code confirmed its neutrality regarding the choice of company form or form of management (separation of the offices of chairman and chief executive officer or combination of such offices).

In 2017, the High Committee looked into possibly taking a position regarding the choice between separation of the offices of chairman and chief executive officer or combination of such offices, and considered that it was not necessary to favour either form.

However, the High Committee considered that it could intervene with regard to this matter:

- by maintaining its vigilance (see § 2.1 above) regarding the explanations expected of companies in terms of "motivation" for their choice, as recommended by § 2.3 of the Code (presentation of the measures enabling a balance of powers to be ensured, such as the presence of a lead director,

[2] As of the date of this report, the two meetings later than 30 September have not been taken into account.

meetings without the executive directors being present, role of the committees, etc. in companies where the offices are combined) and regarding any deviations (for example, maintaining disproportionate compensation for a chief executive officer who has become a "separated" chairman);

- by recommending that the board regularly debates the suitability of the form of governance chosen, every year for example as part of its self-evaluation or at a meeting without executives being present, and at least whenever the term of office of the chairman and, if applicable, the chief executive officer is renewed.

3.5. Role of the directors in shareholder dialogue

The need for the board of directors to be involved in the relationship with the shareholders (and in broader terms with the investors) has long been recognised, particularly by the Afep-Medef Code. It was mentioned back in the 1995 Viénot I report, which we know underlies the development of the successive versions of the Code. In the current version of the Code, this task is summarised as follows: "*it is up to each Board of Directors to define the company's financial disclosure policy*" (§ 4.1).

Furthermore, the Code only addresses relationships between board and shareholders in the framework of the general meeting, to which § 5 is devoted. Moreover, attending general meetings is part of the "ethical" duties of directors listed in § 19. The Code has only envisaged the individual participation of directors in the process of dialogue with shareholders outside of the context of the general meeting since 2013, in the form of a "special task" that can be entrusted to a director, particularly a vice president or lead director, and which must be described (§ 6.3).

The need for the board of directors' involvement in the relationship with shareholders does not therefore raise any doubt insofar as it takes place in two ways: verification of the information provided to shareholders and the market, and taking part in the general meetings.

However, there is growing pressure from institutional investors for direct dialogue to be established between the directors and the shareholders. This demand is part of a wider trend towards them being involved to a greater extent in the governance of companies:

- establishment of specialist governance services and publication of voting policies among the most structured investors, increase in general meeting resolutions being challenged, *stewardship codes*, provisions of the European "Shareholders' Rights" Directive, etc.;

- encouragement of broader dialogue with issuers "upstream" of general meetings, particularly from the AMF (2011 recommendation on proxy advisors, 2012 report on general meetings, etc.) and *proxy advisors*;

- improvement of means and practices on the part of issuers (*investor relations* services, conference calls and *road shows*, prior negotiation of meeting resolutions with the main shareholders and the *proxy advisors*, etc.).

According to certain institutional investors which publish their corporate governance policy, direct access to the directors is particularly justified in the following circumstances: specific crisis or concern, need to check that the board is fulfilling its duties, major operations.

Dialogue with the directors is common practice in the United Kingdom and the United States, as part of a regulated framework. The *UK Corporate Governance Code* considers that shareholder dialogue is a collective responsibility of the board, but assigns a specific role to the *chairman* and the *senior independent director*: the chairman must "discuss governance and strategy" with the main shareholders, ensure that their concerns are brought to the board's attention, and make sure that the independent directors and in particular the *senior independent director* take part in meetings with the

shareholders if they wish it. In the United States (where there is no governance code according to the European understanding of the term), directors' organisations recommend a dialogue involving the independent directors, particularly the *chairman* and the *lead director*, with the large long-term shareholders.

This practice is subject to various impediments in France that are not always understood by foreign investors: an unfavourable legal context, and practical difficulties to which the market is more sensitive than elsewhere due to the responsibilities incumbent on the executive.

Legally, caution with regard to individual contacts between directors and the shareholders or investors is justified by:

- concern not to jeopardise the collective nature of the board, which prohibits a director from publicly taking a personal position;

- the need to comply with obligations relating to public information that apply to contacts with investors. Even though these contacts do not lead to the slightest commitment on behalf of the company, they may lead to some of them being given information under these obligations which of course also apply to the general management and its employees. However, the directors may be reluctant to take on this responsibility which is not strictly speaking part of their mission.

In addition to this legal consideration there is the practical risk of contradictions between the comments made by the directors and the general management's positions, especially since the objective sought by the shareholders is sometimes to confirm the information given by the "official mouthpiece".

It should be noted that German issuers, subject to pressure comparable to that seen here when their legal model is just as removed from the Anglo-American model as ours, are also acting with caution. The latest version of the Deutscher Corporate Governance Kodex, adopted in February 2017, contains the following addition: "*the Supervisory Board Chair should be available – within reasonable limits – to discuss Supervisory Board-related issues with investors"* (§ 5.2). Intervention in the dialogue with the shareholders is therefore reserved for the chairman of the board (statutorily representing the shareholders within a body consisting, in large companies, of one-third or one-half employee representatives). Moreover, it should not be forgotten that supervisory boards are compulsory in Germany. The distinction between their spheres of competence and those of management boards is no doubt easier than for a board of directors/chief executive officer combination.

The High Committee is of the opinion that directors' involvement in shareholder dialogue outside of the context of general meetings is tending to become an expectation among investors. However, it recommends that certain precautions are followed. These recommendations are as follows:

- it is up to each board to review the dialogue arrangements;
- if the company's form of governance is a form of separated chairmanship (or supervisory board), the task can revert to the chairman of the board: in this case, it is part of the "tasks entrusted in addition to those conferred by law" which must be described in accordance with § 2.2 of the Afep-Medef Code; it can also be entrusted to a lead director or vice president of the board, or indeed to another director, but it is not desirable to disperse the responsibilities by having multiple contact people;
- the person chosen must preferably have institutional communication experience, and receive appropriate training where necessary;

- the first task must be to explain the positions adopted by the board in its spheres of competence (particularly as regards strategy, governance and executive compensation), and which have been communicated beforehand; this implies close coordination with the chairman of the board if he is not the person to whom the task is entrusted;
- it may then be to ensure that the shareholders receive the information they expect concerning the company (and not to provide this information); this implies close coordination with the chief executive officer or his employees responsible for shareholder relations, and the meetings or telephone contacts must, unless explicitly requested by the contact people, be carried out in their presence;
- the director must report to the board on the performance of his task.

3.6. "Shareholders' Rights" Directive applicable in 2018

The High Committee has perused the main provisions of the European Directive of 17 May 2017 to "encourage long-term shareholder engagement". It is of the opinion that these provisions will help improve companies' governance and enhance the equal treatment of European undertakings with respect to the responsibilities imposed on them by the regulations in this sphere. However, subject to what the transposition into French law might bring, the reforms arising from this directive should not bring about a significant revision of the Afep-Medef code. Issuers knowing their shareholders better, increased transparency of institutional investors and stricter rules governing proxy advisors will encourage dialogue with shareholders, in which the High Committee recognises that boards of directors must be actively involved (see § 3.4 p. 20 above). The regulations governing "transactions with related parties" should not add significant further constraints for French companies compared with the existing regulations. As for widening the *say on pay*, we know that the *ex-ante* and *ex-post* dual voting mechanism already introduced by French law is even more stringent than that of the directive, since it is mandatory that it is carried out every year. Even if the system transposed by the other Member States of the EU is more flexible, in particular regarding *ex-post* voting, it should nevertheless result in a relative degree of harmonisation of practices within European undertakings.

HCGE

Haut Comité de Gouvernement d'Entreprise

55, avenue Bosquet
75007 Paris
Tel. : +33 (0)1.53.59.17.49