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The evolution of the regulatory framework around the "Say-on-Pay" in France

In the light of the Shareholder Rights Directive II taking effect across member states of the European Union and being transposed into local law, IHS Markit's Corporate Advisory Team would like to take the opportunity to give a brief overview of the effects the transposition will have for French corporate issuers and the marketplace with the French Proxy Season kicking off.

General principles

The PACTE Law transposes into French law part of a European directive which seeks "to promote the long-term commitment of shareholders" (EU Dir 2017-828, 17 May 2017). The long-awaited Order and Decree of 27 November 2019 include the European directive's provisions regarding the remuneration of corporate officers at listed companies. In contrast with several other European markets, here the changes are mostly to adapt the pre-existing framework.

It applies to:

- All companies listed on a regulated market. The framework now includes partnerships limited by shares (sociétés en commandite par actions or "SCA" e.g. Michelin, Groupe Lagardère, Hermès International, Rubis, etc.).
- All corporate officers, including non-executive members at boards of directors.
- All remunerations, including:
  - Those due in title of agreements entered into with an executive corporate officer to compensate the anticipated termination of their mandate which were previously subject to the related-party transaction process.
  - The remunerations paid by subsidiaries in title of an employment contract. Although the exact scope of remunerations covered is not all clear, it covers the post-employment remunerations. For what remains unclear, based on past experience, it seems like shareholders and their voting advisors are likely to interpret the law in its wider acceptance.

Actionable items:

1. The resolution targeting non-executive directors: consider disclosing the individual remuneration due in title of the fiscal year under review (ex post) and the allocation key for each level of responsibility (board member/ chairperson, committee member/chairperson) – individual attendance rates should be consistent with attendance-based remuneration.
2. At partnerships limited by shares, engagement as well as studying peers' practices are keys for understanding new expectations. After the Sapin II Law, several SCA companies maintained say-on-pay items on their agendas although not legally required. This can help identifying good practices.
3. Transparency on all remuneration elements due under an ongoing employment contract should be considered with a focus on post-mandate remuneration components (severance agreements, non-compete clauses, pensions schemes).

The road so far

The amended law passed at the end of November was mainly an update of what already existed in France. The European context, most likely, with the “new” European Shareholder Rights Directive (SRD II) was indeed decisive in defining these changes. The law also reflects political inclinations and messages due to the social context in France and several past controversies regarding compensation in France.

In December 2016 already, and notably following what we now know as a first chapter in the Carlos Ghosn case at Renault, the Sapin II Law, introduced a regulatory ‘say-on-pay’ at French listed companies. The legislator decided to institute two separate annual binding votes on remuneration:

- Ex ante, with a vote on the remuneration policy for the companies’ executives and supervisory board members;
- Ex post, with a vote on the individual remuneration due in respect of the prior year.

This is the second version of the “French say-on-pay” as a first version was initially introduced in the local governance code in late 2013. At this time, it was a non-binding ex post vote for companies who were explicitly referring to the Afep-Medef code. With this background, there are already well-established remuneration disclosure standards in France. Consequently, the level of information available, notably at SBF 120 companies, is often recognized as satisfactory by the French Market Authority and the High Committee for Corporate Governance, also known as HCGE (the body that monitors the application of the Afep-Medef code).

Core changes: ex ante

Regarding the ex ante vote, the remuneration policies targeted by the amended law must now cover all corporate officers, including non-executive directors, with a resolution which will be put to a vote annually. This will potentially make AGMs agendas heavier..

There is leeway for companies to personalize certain elements in different resolutions that could be individualize for all corporate officers. The AMF recommends to submit more than one bundled resolution. The idea behind this structure is to prevent more dissent, as resolutions composed of one single contested element will more likely to be opposed as a whole.

Although, one question remains: in the event of one specific resolution being rejected, is there a chance to see the entire policy being turned down? The AFEP-MEDEF Code does not provide an answer on this point.

However, if it indubitably will add more resolutions to the agenda, there is an opportunity for a company to get a better understanding of the shareholders' vote by individuals.

Accordingly, under the most common scenario, the policies will have to include information on the performance conditions applicable to variable elements, not only their nature but also the process applied to determine the level of achievement of these criteria. However, in exceptional circumstances, the amended law gives some flexibility, as boards may decide to temporarily move away from the remuneration policy. This exemption is subject to the disclosure of detailed procedural conditions under which these exemptions may apply.

It is worth noticing that the law provides a detailed framework in the event of a rejected resolution:

- In such case, the previously approved remuneration policy continues to apply, but the Board must submit a new resolution to a vote at the next General Meeting.
- In the absence of a previously approved remuneration policy and if the draft resolution is not approved at the General Meeting, the remuneration is determined pursuant to the remuneration awarded during the previous financial year. If no compensation was awarded in the previous year, this compensation is determined according to existing practices within the Company.
- Any award or payment coming from remuneration components that would not comply with the remuneration policy previously approved by shareholders would be deemed null and void.

Lastly, and in line with the SRD II, the business long-term strategy must be explicitly supported by the remuneration policy, with a focus on sustainability. To comply with this requirement, companies will need to clarify how the remuneration and employment conditions of the company's employees are considered.

Actionable items:

1. The level of achievement of performance conditions is a key indicator for shareholders to understand the link between the company’s performance and the actual remuneration payout. For quantitative metrics, the disclosure is straightforward as the comparison between a quantitative target and the results is almost self-explanatory. For qualitative metrics, a detailed narrative on key achievements proved to be well accepted, especially when these criteria account for less than half of the variable scheme.

2. Although not compulsory, alignment between executive remuneration and sustainable performance is more and more expected, as reflected by the wording of the Pacte Law. Here, there is a case for aligning the materiality assessment, the CSR Roadmap targets, and the variable remuneration scheme(s).

Core changes: ex post

For the ex post vote, two different type of resolutions will be put forward to the agenda for corporate officers, including non-executive directors.

The first part will focus on the remuneration report and, where applicable, on variable and exceptional remuneration paid during the past financial year or allocated during the current financial year. The report includes the remuneration paid to non-executive directors. This section is also following the requirements of the Pacte Law in 2016, the law introduces "fairness" ratios for every single executive corporate officer. Aiming to assess their remuneration, the comparison will use both the average and median of employees' compensation. Adding to that, companies will have the opportunity to fully explain their pay structure and metrics and give a rationale on why this structure will contribute to a long-term strategy and how compensation is aligned with performance.

An interesting development which could be directly linked to the new requirements provided by the amended law in case of a negative vote:

- **The Directors' or Supervisory Board members' remuneration is suspended.**
- **The Company must convene a new General Meeting to submit a revised remuneration policy.**
  - If the resolution is approved, the variable and exceptional components must be paid, according to the newly approved policy.
  - If the revised remuneration policy is not approved, the initially suspended elements remain suspended. The Company must resubmit a revised policy. Under this scenario, it seems the remunerations will be definitively lost.

This new provision can be seen as a way to put additional pressure on Boards, notably in case of minority dissent higher that 20 percent of votes cast at the previous AGM, and in the absence of what shareholders would consider as a sufficient reaction.

A second section, more specific, will focus exclusively on executive corporate officers' individual remuneration, plus that of the non-executive Chairman, if any. The proposals are to approve the variable and exceptional components paid or due in title of the previous fiscal year; as was previously the case.

In case of a negative vote, the fixed elements of remuneration for each beneficiary remain. However, the variable and exceptional remuneration cannot be paid.

Finally, a statement on how the previous AGM's vote on remuneration is considered has to be included in the information given to shareholders. This new requirement could be seen as an opportunity to justify any deviation from the policy during the year under review. It is also a possibility to discuss remuneration provisions approved by shareholders yet, significantly criticized.

Actionable items:

1

Although the methodology behind the fairness ratios calculation should be clear, the way they will be analysed remains unknown. Any criticism arising from shareholders and proxy advisors should be questioned as follows: what the best practice is, paying wages higher than average in a low-wage work market/industry or paying wages lower than the average in a high-wage work market/industry? The former would have a negative impact on the pay ratio (whereas it could have a globally more positive impact), and conversely for the latter.

2

Academic studies, voting guidelines, activist campaigns, all tend, among other phenomenon, to promote continuous engagement with shareholders and not only before the AGM. In case of significant dissent, and to avoid the newly enacted process in case of rejected proposal, it will be expected that the IR, board secretary and eventually board members themselves, engage with shareholders to understand and take into consideration the dissent. Reporting on how shareholders' feedback was collected and integrated will mitigate the discontent.

Three significant improvements in the new version of the French “Say-on-Pay”

Globally, the amended law introduces some interesting changes, that will need to be closely monitored over the next years.

- **Clawback provisions:** In the decree possible deferral periods and, if applicable, the possibility for the company to claim the return of variable remuneration is mentioned. Known as “clawback”, these provisions seem however hardly applicable in France. They are widely included in remuneration policies across Europe: in Netherlands for instance, where companies are being allowed to ask for the return of any bonus granted based on false information, or in the United Kingdom, where companies can take back all the variable that has been paid (annual bonus, stock options, free shares) for the last seven years.

  In France, it is facing the reality of the local law. Because of the Labor Code, when a payment has been carried out, there are limited possibilities of recovering the money from the beneficiary. For example, it would take a proven misconduct by the corporate officer which put the company at risk to claim the money back.

Actionable items:

1

To circumvent this obstacle, deferring the payment over several years could be an option.

- **Strategy alignment:** Following the implementation of the SRD II and the global trend, the law significantly increases the information that must be included in both the remuneration policy and the remuneration report. Consequently, this obligation to describe how the remuneration policy for all corporate officers is in line with the company’s interest and contributes to the commercial strategy and the sustainability of the company will automatically draw attention on the integration of non-financial KPIs, especially the ESG ones.

2

These are not mandatory, but the potential introduction of such criteria will be highly scrutinized by shareholders as the law underlines that these criteria should be subject to the same level of analysis, stringency, and transparency as any other performance condition (notably the financial ones) as discussed under the “Core changes: ex ante” section above.

- **Combined termination packages:** Some clarification has been provided on non-compete agreements, in line with the last modification of the Afep-Medef code in June 2018. Back in 2017, Carrefour’s CEO Georges Plassat faced pressure over his payout. When he stepped down in July 2017, he was eligible to a clause in his departure package under which he would get nearly 4 million euros for committing not to join a competitor. M. Plassat was due to retire at the age of 68 and left the Board accordingly. A situation identified as a potential “disguised retirement benefit” by the proxy advisory firm Proxinvest. This highly discussed issue, criticized by the global Proxy Advisory firms ISS and Glass Lewis as well, may have been the starting point of the changes recently included in the amended law.

3

Considering past controversies, it is certain that such scenario would raise higher criticism. To avoid such situation, when the policy includes a non-compete agreement in the case an executive is stepping down due to retirement, these payments will be suspended. The law therefore makes this combination impossible, yet it is worth showing explicitly in the report that is has been duly monitored.

There’s no revolution in France…yet ?

As a matter of fact, the updated law implemented a certain number of new features which give more detailed information to shareholders. The goal here is to allow them to make a real impact on company’s decisions given the binding nature of the votes. This confirms the unique French approach on these proposals. The level of detail requested under the annual ex ante vote on the remuneration policy makes it look like an anticipated version of the ex post vote. This particular situation clearly stands out from others within the EU where the policies will be carried over several years.

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