

The AFEP-MEDEF: a long-awaited reform?

Written 23/07/2013

Can we talk about a “spring of corporate governance” in France? Difficult to say. Although the months of May and June 2013 saw many changes increase on this issue, the results are far from revolutionary. An abandoned draft law, a report on responsibility and company performance, and a revised version of the AFEP-MEDEF* Code; whereby the underlying logic to these developments is difficult to follow for the casual observer. What are the positives of the new AFEP-MEDEF Code and to what extent does it differ from Clément-Houillon’s report proposals? Mirova aims to find out and identify the work still to be done.

An ambitious draft law...

Published on the 16th June 2013, three weeks after abandoning the new draft law on corporate governance, the new version of the AFEP-MEDEF Code introduces a series of recommendations to support changes in practices, without disturbing any corporate governance structures.

As one of François Hollande’s campaign promises, controlling executive officers’ remuneration has been part of an ambitious draft law, the abandonment of which surprised numerous stakeholders. A report providing information on the “transparency of the corporate governance of large companies,” one of the constituent parts of this dossier, presented by reporters Jean-Michel Clément and Philippe Houillon, traced the contours of a large-scale reform based around three objectives:

1. Reinforce the balance between law and governance codes
2. Establish open and stable corporate governance for shareholders and employees
3. Favour responsible corporate governance for long-term strategies

...abandoned in favour of a demanding self-regulation

The current context is a reminder of how much the words of recently deceased sociologist, Michel Crozier, still resonate: “*We cannot change society by decree*”. Unlike the decree which capped public company executives’ pay to 450,000€ put in place last July 2012, this time, the government has chosen the path of dialogue in favour of, according to Minister of Economics and Finance, Pierre Moscovici, a “*demanding self-regulation*” over a legislative act. This approach reflects the

government’s willingness to support the development of French companies without “*fixing the rules in law when they are continually forced to evolve in a changing international environment*”. Therefore, what are employer organisations proposing?

Timid first steps from shareholder to stakeholder value?

The analysis of the new AFEP-MEDEF code reveals the beginning of a paradigm shift that marks more responsible corporate governance. When previously corporate governance mechanisms aligned executives’ interests with those of minority shareholders, they now focus more on a company’s “social interest.” This change in perspective is reflected in the definition of the role of the Board and managers, and in the remuneration system objectives. This development is altogether positive in how it marks the end of the supremacy of shareholder interests over those of the company and consequently, other stakeholders. However, the lack of clarity on what is meant by the “social interest of the company” denotes a certain freedom of interpretation depending on the perception of a company’s role to either only make profit for its shareholders, or to expand its area of responsibility further to include a global responsibility approach, as defined in the Brovelli-Drago-Molinié report.

Mirova’s recommendations:

- *Establish a clearer definition of “social interest” of the companies and elements associated with it by integrating CSR challenges.*

* Afep (French association of private companies) / Medef (French organisation representing companies and employers).

Introduce a “lighter” version of Say on Pay

This new version of the AFEP-MEDEF Code enhances the role of shareholders in corporate governance through, amongst other significant measures, the establishment of an advisory “Say on Pay” vote, giving shareholders the power to control remuneration without it being a legal obligation.

In recent months, little known to the French, Say on Pay has emerged across the European and national media scene (see the example of Switzerland). The aim of Say on Pay is supposedly to promote transparency and encourage fairness in terms of remuneration, and represents the government’s intention to make business leaders responsible to their companies’ shareholders and other stakeholders. However, its real scope depends on its application, which is the subject of heated debate amongst issuers (anxious to preserve the power of the Board), shareholders (concerned about their financial interests) and governments, whose will is to limit excessive remunerations and civil society, for whom remuneration is inseparable from issues of social justice.

In addition, its ability to achieve its objectives is often questioned. England, for example, introduced Say on Pay over 10 years ago and its government is now considering establishing a more restricted regulatory framework.

“ Define “social interest of the company” by introducing a global responsibility approach

In France, the measure appears to be a reasonable compromise to the version proposed by the Clément-Houillon report. The consultative nature of the ex-post shareholder vote on remuneration does not reflect any real transfer of power, unlike the ex-ante vote on remuneration policies. In addition, we may question the scope of a Board’s obligation to respond to a negative vote by a press release. Would this be sufficient to promote change in practices? It is vital that this measure be supported by fruitful dialogue between stakeholders ahead of General Assemblies.

Mirova’s recommendations:

- *Generalise dialogue ahead of General Assemblies.*
- *Submit remuneration policies to an ex-ante consultative shareholder vote.*

Extra-financial: majorly lacking in the reform...

One of the positive measures is the introduction of the notion of “long-term” in recommendations on variable remuneration mechanisms. Nevertheless, just like the notion of “social interest of a company”, the Code offers little clarity as to the way in which companies should implement long-term remuneration systems. Today, bonuses, stock options and free shares are all indexed on performance criteria that are essentially quantitative – mainly financial – and remain short-term, a significant factor of the current crisis.

Although several actors had expressed the desire to include social and environmental performance criteria in granting executive director’s remuneration, no precise recommendation has been made regarding the consideration of extra-financial criteria. This represents a key difference to the Clément-Houillon report, which juxtaposed this proposition with that of the introduction of a Say on Pay vote.

This is an area of improvement for France to explore if it is to provide truly ambitious and reliable corporate governance measures. The Brovelli-Drago-Molinié mission also highlights this measure as a strong incentive to promote the integration of CSR issues at the heart of business strategies, and also portrays the integration of ESG criteria not as a simple question of ethics, but as a real lever for company performance and long-term value creation for all stakeholders.

Mirova’s recommendations:

- *Consider extra-financial (ESG) criteria in the allocation of variable elements of remuneration.*
- *These criteria must be clearly defined in the remuneration policy and be in accordance with the long-term strategy of the company.*

...which is more geared towards limiting abuse than a paradigm shift.

The following are the other measures regarding the issue of remuneration:

- Introduce a “multi-year” variable to incorporate long-term remuneration
- Introduce a transparent recommendation on the allowance of golden hellos
- Introduce a seniority requirement of at least two years to be eligible for retirement plans, with a gradual acquisition of rights limited to 5% per annum and a maximum private income cap of 45% of reference income (which isn’t precisely defined within the Code)

- Introduce a recommendation for better supervision of non-competition remuneration.

These measures will certainly help better manage current practices by restricting certain cases of abuse, but are still far from addressing the real issues highlighted by these remuneration mechanisms, particularly their fair correlation to long-term value creation for the company.

Mirova's recommendations:

- *Clearly define the notion of "multi-annual" remuneration.*
- *Establish evaluation periods of a minimum of three years for stock-option performance.*
- *Introduce precise recommendation on the transparency of criteria, price scales and objectives linking all elements of remuneration to company performance.*
- *Improve ex-post transparency of performance objectives and their level of achievement.*

Social dialogue: how to assess the recommendations?

In a depressed economic and financial context, corporate governance issues are at the heart of concerns linked to the social pact. It is now necessary to integrate these concerns to the performance of the company by creating the necessary structures for constructive and successful dialogue. To do this, initial efforts must be made within the company. Thus, the Clément-Houillon report recommended in its propositions 10 and 11 "to establish a compulsory non-shareholder employee representation by law, with voting rights, at board and supervisory-board level for companies with more than 5000 employees" and to "improve social dialogue" by ensuring employees have suitable training systems.

The Brovelli-Drago-Molinié report will in turn further promote the involvement of certain employee representative bodies in the elaboration of company CSR policies. Believing that corporate governance structures will act as an essential lever in establishing a social dialogue that will promote a company's sustainability, this report offers to create an ad-hoc "sustainable development" committee that will promote the integration of these issues into the Board's discussions regarding the company's business strategy.

“ Integrating ESG criteria is not a simple question of ethics, but a real lever for company performance and long-term value creation for all stakeholders.

The new AFEP-MEDEF Code is geared towards greater employee involvement in corporate governance. Recommendations on employee representation are now the subject of a specific chapter; nevertheless the AFEP-MEDEF merely provides a reminder of regulatory requirements regarding employee shareholder representation (Art. L.225-27 and 27.1). The participation of these directors on the committees is mentioned, without being encouraged nor recommended, with the exception of the committee in charge of remuneration where it is advised that a director represents employees.

Although there may be a lack of conviction in these proposals, we will hope that this development will be accompanied by a shared commitment on behalf of both parties to implement constructive dialogue in the interests of the company.

Mirova's recommendations:

- *Create a "sustainable development" committee to promote the integration of ESG criteria in business strategies.*

What independence for the High Committee of Corporate Governance?

Amongst the key features of this new code is the creation of a High Committee for monitoring companies in the implementation of the Code's recommendations.

This committee, made up of seven people consisting of four issuers, and three qualified investor representatives or those skilled in legal or ethical areas, may be referred to by the Boards for all Code-related matters.

They can:

- use their own initiative if they find that a company does not sufficiently justify the non-application of a recommendation,
- propose updates to the Code in light of changing national and international practices.

They will also publish an annual report of their activities.

This new control system is designed to meet demand from various stakeholders from the consultation launched by the Treasury in August on executive remuneration. The consultation's objective was to strengthen the effectiveness of the "comply or explain" device via its enforcement by an independent regulatory authority (e.g. AMF). We can now question the future independence of the body, whose composition raises serious issues of conflict of interest.

Mirova's recommendations:

- *Enforce regular consultation with all stakeholders from the High Committee of Corporate Governance in order to incorporate their comments in future modifications of the Code of Governance.*
- *Carry out an inspection on behalf of the High Committee made up of majority independents.*

“ Corporate governance structures are an essential lever in establishing a social dialogue that promotes a company's sustainability.

Conclusion

The main measures introduced by the new AFEP-MEDEF Code are progressing in the right direction i.e. introducing the notion of social interest, employee participation in corporate governance, a shareholder advisory vote on remuneration, etc. However, this progress remains insufficient to prepare the companies for the challenges they will face in a radically changing economic environment, subject to external pressures of an environmental and social nature.

The introduction of more incentives to the inclusion of CSR in business strategies, such as the creation of a committee dedicated to CSR at Board level and the integration of environmental and social objectives in remuneration policies seems essential in this respect.

Bibliography

- **Le Figaro.fr** (24/05/2013) – « *Le gouvernement renonce à limiter la rémunération des patrons* ».
- **Le Figaro.fr** (16/06/2013) – « *Rémunération des patrons, Hollande accepte les propositions Afep-Medef* ».
- **J-M Clément & P. Houillon** (22/02/2013) - *Rapport d'information sur la transparence de la gouvernance des grandes entreprises. Assemblée Nationale.*
- **L. Brovelli, X. Drago, E. Molinié** (juin 2013) - *Responsabilité et performance des organisations, 20 propositions pour renforcer la démarche de responsabilité sociale des entreprises.*
- **Code Afep-Medef** - Versions 2010 et 2013.

DISCLAIMER

This document is destined for professional clients. It may not be used for any purpose other than that for which it was conceived and may not be copied, diffused or communicated to third parties in part or in whole without the prior written authorization of Natixis Asset Management. None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information.

It constitutes a presentation conceived and created by Natixis Asset Management from sources that it regards as reliable. Natixis Asset Management and Mirova Environment and Infrastructure reserve the right to modify the information presented in this document at any time without notice and particularly the information concerning the description of the management processes which does not in any way constitute a commitment on behalf of Natixis Asset Management or Mirova Environment and Infrastructure. Natixis Asset Management and Mirova Environment and Infrastructure will not be held responsible for any decision taken or not taken on the basis of information contained in this document, nor in the use that a third party may make of it. Figures mentioned refer to previous years. Past performance does not guarantee future results. Reference to a ranking and/or a price does not indicate the future performance of the UCITS or the fund manager.

The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material.

The funds managed by Natixis Asset Management and mentioned in this document have received the approval of the French Financial Market Authority (AMF) or have received authorization to be marketed in France.

Under Natixis Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Natixis Asset Management do not invest in any company that manufactures sells or stocks anti-personnel mines and cluster bombs.

The funds managed by Mirova Environment and Infrastructure are not subject to the French Financial Market Authority agreement and can adopt exceptional rules of investment described in the legal prospectus.

Before making any subscription, investors must verify if they are legally authorized to subscribe to an UCITS; in particular, subscription to the funds managed by Mirova Environment and Infrastructure is strictly reserved for well-informed investors answering the criteria defined in their regulation.

Characteristics, risk and return profile and costs related to investment in a fund are described in the Key Investor Information Document, available on request from Natixis Asset Management.

In the case of funds that qualify for a special tax status, we remind potential investors that the special tax conditions depend on the individual situation of each investor and that such conditions may be subject to future modification.

This material is provided only to investment service providers or other Professional Clients or Qualified Investors and, when required by local regulation, only at their written request.

• **In France**, the prospectus and the periodical reports are available on request from Natixis Asset Management or Mirova Environment and Infrastructure. Potential subscribers must be in possession of a copy of the Key Investor Information Document before making any subscription.

• **In the EU (ex UK)** Distributed by NGAM S.A., a Luxembourg management company authorized by the CSSF, or one of its branch offices. NGAM S.A., 51, avenue J.F. Kennedy, L-1855 Luxembourg, Grand Duchy of Luxembourg.

• **In the UK** Provided and approved for use by NGAM UK Limited, which is authorized and regulated by the Financial Conduct Authority.

• **In Switzerland** Provided by NGAM, Switzerland Sàrl. • In and from the DIFC Distributed in and from the DIFC financial district to Professional Clients only by NGAM Middle East, a branch of NGAM UK Limited, which is regulated by the DFSA. Office 603 – Level 6, Currency House Tower 2, P.O. Box 118257, DIFC, Dubai, United Arab Emirates.

• **In Singapore** Provided by NGAM Singapore (name registration no. 5310272FD), a division of Absolute Asia Asset Management Limited, to Institutional Investors and Accredited Investors for information only. Absolute Asia Asset Management Limited is authorized by the Monetary Authority of Singapore (Company registration No.199801044D) and holds a Capital Markets Services License to provide investment management services in Singapore. Registered office: 10 Collyer Quay, #14-07/08 Ocean Financial Centre. Singapore 049315.

• **In Hong Kong** This document is issued by NGAM Hong Kong Limited and is provided solely for general information only and does not constitute a solicitation to buy or an offer to sell any financial products or services. Certain information included in this material is based on information obtained from other sources considered reliable. However, NGAM Hong Kong Limited does not guarantee the accuracy of such information.

• **In Japan** Provided by Natixis Asset Management Japan Co., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 2-2-3 Uchisaiwaicho, Chiyoda-ku, Tokyo.

The above referenced entities are business development units of Natixis Global Asset Management, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. Although Natixis Global Asset Management believes the information provided in this material to be reliable, it does not guarantee the accuracy, adequacy or completeness of such information.

 Visit us: www.mirova.com

 Follow us: @Mirova_RI

Mirova. Responsible investing

Mirova is a brand of Natixis Asset Management. The Infrastructure financing activity is managed by Mirova Environment and Infrastructure, a subsidiary of Natixis Asset Management.

NATIXIS ASSET MANAGEMENT

Limited Company - Share Capital: e50 434 604.76
RCS Paris 329 450 738 - Regulated by AMF: GP 90-009
Registered Office: 21 quai d'Austerlitz - 75634 Paris Cedex 13

MIROVA ENVIRONMENT AND INFRASTRUCTURE

A French simplified joint-stock company - Share Capital: e550 000
RCS Paris 394 648 216 - Regulated by AMF: GP 02 014
Registered Office: 21, quai d'Austerlitz - 75013 Paris

AN EXPERTISE OF  **NATIXIS**
GLOBAL ASSET MANAGEMENT