AMF 2009 REPORT 0N CORPORATE GOVERNANCE AND INTERNAL CONTROL

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Executive Summary

This report has been prepared in accordance with Article L. 621-18-3 of the Monetary and Financial Code, originating from the Financial Security Act of 1 August 2003. The Autorité des marchés financiers (AMF) has a statutory duty under the Act to draw up an annual report based on information on corporate governance and internal control published by corporate entities having their registered office in France and financial securities admitted to trading on a regulated market.

The section of the report dealing with dealing with compensation of executive directors was published separately on 9 July 2009[1]. Since then, a supplementary AMF report on executives compensation in listed companies and implementation of the AFEP/MEDEF recommendations has been added and incorporated into this report (see page 74).

This is the sixth AMF report on corporate governance and internal control procedures in listed companies. It is based on an analysis of disclosures by a sample of 100 companies with shares listed on Euronext Paris.

The first section deals with methodology and a review of prevailing legislation, rules and standards (I). Based on observations made by the AMF when analysing companies' submissions, the report proposes areas for discussion, along with recommendations, on corporate governance (II) and internal control (III).

The keynote issues of 2008 were the extent of the financial crisis and the initiatives taken at international, European and domestic levels to restore confidence and stability in financial markets. Discussions about corporate governance, risk management and internal control, though admittedly focused on financial institutions, nevertheless raised awareness of the importance of risk control and good governance.

In its analysis of the 2008 financial crisis, the OECD [2] has identified four aspects of corporate governance where improvements are needed: board performance; risk management; compensation practices; and shareholders' rights.

The OECD sees the need for common principles of corporate governance, notably for risk management purposes, even though financial institutions are more sensitive to operational, reputational and liquidity risks.

Moreover, 2008 saw the transposition into French law of two key European directives on corporate governance and the organisation of risk management:

- The Statutory Audit Directive of 17 May 2006,[3] transposed by the Executive Order of 8 December 2008, requires listed companies and those with equivalent status to set up a specialised audit committee to monitor the preparation and auditing of financial and accounting information (cf. Commercial Code, art L.823-19 and 823-20);

- The Corporate Governance Directive of 14 June 2006[4], transposed by the Act of 3 July 2008 (DDAC Act), whereby companies are required to specify which corporate governance code they follow and, when applicable, explain why they have not adopted some of its provisions. The latter provision means that companies are now obliged to comply with the "soft law" laid down in corporate governance codes issued by

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[1] AMF report on executive compensation in listed companies and implementation of the AFEP/MEDEF recommendations, published 9 July 2009.

[2] "Corporate Governance and the Financial Crisis: Key Findings and Main Messages", OECD, June 2009.

[3] Directive of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

[4] Directive 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings.

professional organisations, or, if they do not do so wholly or partially, to explain why. Moreover, by reconciling soft law with prevailing legal standards and implementing the "comply or explain" precept, it is possible to adapt these principles to the specifics of each firm, notably small and medium capitalisation companies (hereafter, "small and midcaps").

The key trends covered in the 2009 AMF annual report on corporate governance and internal control can be summarised as follows:

Corporate governance

Encouraging results that reflect ongoing improvements in French companies' corporate governance practices

Better information about the functioning, results and assessment of the board

- Rules of procedure: these are becoming more widespread, especially in small and midcaps (82% said they had such rules, which are available to the public in 77% of cases);
- An increase in the number of companies that publish a detailed report on the work of their boards: 77% of issuers compared with 69% last year;
- 82% of companies describe the special arrangements for shareholder attendance at annual general meetings.

More systematic reference to a corporate governance code and widespread use of " comply or explain "

- 81% of companies say they use the AFEP/MEDEF Code as their corporate governance code;
- 67% of these companies (54 in all) say they have set aside some of the provisions of the AFEP/MEDEF Code, and 80% of those 54 explain why they have done so;
- 76% of companies follow the AFEP/MEDEF criteria to define a director as an independent director.

Increase in the proportion of independent directors on boards and committees

- 90% of boards have independent directors, who on average account for 46% of directors;
- The definition of "director independence", as construed by companies, is provided in 89% of cases;
- The proportion of independent directors sitting on compensation committees is 57% (compared with 50% in 2007).

Increase in the number of audit and compensation committees, with more independent directors sitting on them

- The proportion of companies with an audit committee has risen to 79% compared with 72% in 2007, especially among small and midcaps (60% in 2008 compared with 46% in 2007); 98% of companies in Segment A have an audit committee, the same number as the previous year;
- The proportion of companies with a compensation committee has also risen (75% compared with 73% in 2007), particularly among small and midcaps (56% in 2008 compared with 50% in 2007); 94% of Segment A companies have a compensation committee;
- Independent directors account for 67% of audit committee members (60% for small and midcaps and 70% of Segment A companies);

- 71% of the chairmen of the audit committees in the sample companies as a whole are independent directors (81% of Segment A companies compared with 55% for small and midcaps);
- 67% of companies with an audit committee provide highly detailed information about how the committee works, and 86% describe the results of its work.

The audit committee's remit is described in nearly all cases.

- "Monitoring the financial reporting process" is mentioned in 100% of cases;
- "Monitoring the efficiency of internal control and risk management systems" is mentioned in 77% of cases;
- "Monitoring the statutory auditors' review of the accounts" is mentioned in 69% of cases and "Monitoring auditor independence" in 68%.

But despite genuine progress, there is still room for substantial improvement in some areas of corporate governance.

Assessing the work of the board and monitoring its results

- The work of the board is assessed via an annual debate in 62% of cases, so there is scope for improvement;
- Even though the proportion of companies that organise a regular assessment of the board's work increased to 52% in 2008, compared with 46% in 2007, further progress can be made;
- The outcome of board assessments is published in 71% of cases, but only 43% of companies describe their plans for improvements;
- Only 53% of companies provide a truly detailed summary of their boards' remit;
- Only 49% of companies carry out a formal three-year board assessment.

Independent directors

- Regarding independent directors sitting on audit committees, 25% of companies refer to these persons' "special skills in finance or accounting" and only one-quarter of them provide a definition of these qualifications.

Recent trends suggest that companies have either not maintained or have reversed their efforts in certain areas of governance:

Compensation committee

- The proportion of compensation committees chaired by an independent director has fallen, from 66% in 2007 to 53% in 2008.

Use of the "comply or explain" principle and reference to an industry code

- 22% of the companies that set aside parts of their reference corporate governance code do not explain their reasons;
- Among the 14 companies that do not apply the AFEP/MEDEF Code, four give no details of the supplementary corporate governance rules in their rules of procedures.

Limits on the powers of the chief executive and deputy chief executive

- Compared with the previous year, there has been a decline in the proportion of companies that say they limit the powers of their chief executive or deputy chief executive. This is true both for Segment A companies (nearly 90% in 2007 compared with 71% in 2008) and for small and midcaps (nearly 40% in 2007 compared with 31% in 2008). Therefore, taking the market as a whole, the assessment is broadly negative.

Reference to the definition of independence and the independence criteria in the AFEP/MEDEF Code

- 38% of companies refer inappropriately to the AFEP/MEDEF criteria on independence, giving few details of the definition and/or setting aside criteria without explanation;
- Regarding the presence of executive directors or non-executive chairman on audit and compensation committees, two compensation committees are chaired by executive directors (both are in small or midcaps) and two audit committees (also small or midcaps) are chaired by non-executives (the chairman of the supervisory board). For Segment A companies, two compensation committees are chaired by non-executives.

Internal control

Encouraging results that reflect continuous improvements made by French companies in monitoring internal control and risk management

Reference to the AMF framework

- The findings of the analysis confirm that the AMF reference framework is the most widely used standard. Seventy-three companies in the sample use a reference framework; of these, 60% apply the AMF framework only, 21% apply COSO and 14% combine the two.

Involvement of operating divisions in internal control

- 85% of companies mention the various divisions involved in internal control and the mechanisms linking them;
- 86% of companies give details of the personnel assigned to internal control;
- 73% of companies mention the risks that internal control has to deal with.

Details of internal control procedures

- The majority of companies give details about their risk identification and management activities, the reason being that this information is mandatory;
- Nearly all companies (97%) give details of their procedures for monitoring risks relating to financial and accounting reporting;
- 77 companies say they have implemented a "continuous improvement approach". Of these, 66% supply detailed information.

Limitations of internal control

- Almost all the sample companies mention that internal control cannot eliminate all the risks they face.

Still room for improvement in some areas of internal control

Further improvements in the way the AMF framework is used

- The companies that apply the AMF framework for internal control purposes do not always adopt the full set of objectives. Reliability of financial reporting and compliance with laws and regulations are cited by 96% and 91% of companies, respectively, but only 43% cite the smooth functioning of internal control processes, especially those that contribute to asset preservation;
- 73% of companies mention the specific risks they have to cope with. But only 69% establish a link between identification of these risks and the procedures employed to manage them;
- Only 51% give details of their procedures for legislative and regulatory compliance and 57% describe operational arrangements for monitoring specific risks.

Organisation of internal control and risk mapping

- A mere 5% of companies supply a clear organisation chart that makes it possible to identify key internal control personnel and line management reporting arrangements;
- 53% of companies specify that they use a mapping process to identify risks.

Assessment of internal control

- 49% of companies have carried out an internal control assessment. However, only 23% of those that have not done so say they intend to assess their system in the years ahead;
- Of the evaluations carried out in 2008, 89% were done internally and 68% on the basis of a self-assessment questionnaire.
- The results of the assessments were disclosed in 16% of cases, and only 8% of companies expressed reservations or said they had detected shortcomings. Twenty-four per cent of companies have given details about the improvements they intend to put in place.

In light of the findings of this report, four discussion areas have been identified:

Discussion area no. 1: Given the report's observation that there are many different interpretations of what is meant by the independence and financial/accounting expertise of directors (concepts that are referred to in the regulations), discussions could be held on:

- clarifying the concepts of independence and financial and accounting expertise;
- independent directors, and how to square their position with compensation procedures and their role on boards;
- the right balance between independence and competence through the appointment of directors with an appropriate professional activity.

Discussion area no. 2: Begin discussions about boardroom diversity. Aside from the need for boardmembers to have specific individual qualities, such as independence, competence and experience, greater diversity, with more women, foreign directors, and so on, might well help to enhance the quality of work done by boards. This raises the question of the representation of women on corporate boards, which stood at 10.6% at end-2008. It has been established that this issue is closely linked to that of combining multiple corporate offices.

Discussion area no. 3: Hold discussions about the stability of corporate governance arrangements and about explanations provided in this regard, particularly in situations where a company returns to a governance structure it recently abandoned.

Discussion area no. 4: To ensure that boards and specialised committees function in an orderly fashion and with greater transparency, consideration might be given to publishing companies' bylaws in a more obvious way, for example on their website, and to consider a standard format, which might include:

- the composition and operating procedures of boards;
- the distribution of work between senior management and the decision-making body;
- the composition, operating procedures and tasks of specialised committees;
- the directors' charter and the code of conduct, if these documents exist.

The AMF suggests that industry groups take the above guidelines into account when discussing these issues.

Discussion areas relating to internal control and risk management will be covered by the working group recently set up by the AMF on audit committees and internal control[5]. The group has been asked to prepare a guide to audit committees and to suggest amendments to the reference framework for internal control and risk management introduced by the AMF in 2007.

The group began work in October 2009 with a view to:

- setting out practical guidance on the remit of the audit committee, in compliance with the Executive Order, by explaining the terminology used in the Order;
- anticipating the changes to be made in order to accommodate small and medium capitalisation stocks ("small and midcaps");
- re-examining the issue of whether the chairman's report should have an evaluative focus.

The group's findings will be put out to consultation and are due to be made public in summer 2010.

The questions raised by the working also relate to the following issues:

- the linkage between accounting standards, management of the company's business (i.e. methods for recognising income) and internal control and risk monitoring mechanisms;
- the requirement for companies to give a more detailed account of risk management procedures in the chairman's report.

[5] Working group chaired by Jean-François Lepetit and Olivier Poupart-Lafarge, members of the AMF Board. Members include representatives of listed companies, members of industry groups and experts in the areas concerned.

I. METHODOLOGY AND SUMMARY OF THE LEGISLATIVE AND REGULATORY FRAMEWORK

1. Objectives and methodology

1.1. Objectives and sample

1.1.1. Objectives

The objective of the AMF's annual report on corporate governance and internal control is to assess current best practices in these areas at listed companies (Segments A, B and C of Euronext Paris). The report is based on an analysis of information published by issuers on this subject.

In contrast with past reports, the section of this year's AMF report dealing with executive compensation and benefits has been published separately, on 9 July 2009[6].

1.1.2. Sample

The sample consists of 100 companies, distributed as follows:

- Segment A: 50 companies - including 36 in the CAC 40 index on 31 December 2008;
- Segment B: 20 companies;
- Segment C: 30 companies.

The proportions of the sample are identical to those for the previous year's report.

Nearly half (48%) of the companies in the sample were not in the sample for the 2008 AMF report, which covered the 2007 financial year. The companies newly added to the sample can be broken down as follows:

- Segment A: 26% of the companies in the new sample;
- Segment B: 65% of the companies in the new sample;
- Segment C: 73% of the companies in the new sample.

As in the past three reports, to refine the statistical analysis the sample has been divided into two sub-samples of equal size (50/50), one sub-sample contain large capitalisation companies (Segment A), and the other containing small and medium capitalisation companies belonging to Segments B and C). Where relevant, statistics will be given both for the sample as a whole, and with additional detail on Segment A versus small and medium caps.

[6] AMF report on executive compensation and implementation of the AFEP/MEDEF recommendations, published on 9 July 2009.

1.2. Analytic method

1.2.1. Analysis of issuers' disclosures

The registration documents filed by the issuers in the sample were analysed both quantitatively and qualitatively, using a matrix of best practices for corporate governance and internal controls in the French financial markets. This matrix has been revised this year to reflect regulatory amendments, changes to the legislative and regulatory framework and the impact of the economic climate on the issues under review.

1.2.2. Interviews with issuers

The statistical analysis of reports was supplemented by a series of informal interviews conducted with several of the issuers in the sample[7]. The companies interviewed were drawn from the different Euronext segments, including some companies subject to the Sarbanes-Oxley Act, in order to provide a comprehensive view. These exchanges helped the AMF to identify the practical and financial arrangements involved in bringing a company's practices into compliance with the best practices recommended in France. The interviews also gave issuers the opportunity to suggest improvements, offer criticisms and point out problems and limitations that they had encountered.

1.3. Structure of the analysis

1.3.1. Comparative analysis

In addition to distinguishing statistically between large caps and small and medium capitalisation companies when appropriate, this study also has a time-series dimension. Where the cases or findings differ significantly from those for the 2007 financial year (or earlier years), this is explicitly mentioned and analysed.

Where such distinctions are absent, this additional detail has been omitted in order to avoid weighing down the structure of the report.

1.3.2. Recommendations and discussion areas formulated by the AMF

To improve the clarity of this report, the following structure is used throughout the report:

- A review of past recommendations that still apply;
- A statement of practices;
- New AMF recommendations, if any;
- Discuss areas proposed to industry groups.

[7] See Appendix 1 for a summary of these interviews.

2. Legislative and regulatory framework

2.1. European

2.1.1. Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies

The 'Shareholder Rights' Directive strengthens the rights of shareholders in companies whose shares are traded on a regulated market. The directive deals with the voting rights of shareholders and the organisation of general meetings of companies listed on a regulated market whose registered office is located within the European Economic Area.

The directive specifies the rights of shareholders prior to general meetings, their right to put items on the agenda of the annual general meeting and their right to submit written questions concerning business on the agenda. In addition the directive establishes the principle of liberalising proxies and eliminating restrictions on the designation of proxy holders.

This directive has not yet been transposed into French law, but Parliament is expected to take up the matter in the near future.

2.1.2. European Commission Recommendation 2009/385/EC of 30 April 2009:

a)- Concerning shareholder voting rights, the recommendation provides that "shareholders, in particular institutional shareholders, should be encouraged to attend general meetings where appropriate and make considered use of their votes regarding directors' remuneration, while taking into account the principles included in this Recommendation, Recommendation 2004/913/EC and Recommendation 2005/162/EC".

b)- Concerning compensation committees: the recommendation contains provisions dealing with the composition, role and operation of the committee:

- Composition: "At least one of the members of the compensation committee should have knowledge of and experience in the field of remuneration policy";
- Role: "The compensation committee should periodically review the remuneration policy for executive or managing directors, including the policy regarding share-based remuneration, and its implementation";
- Operation:
  - "The compensation committee should exercise independent judgement and integrity when exercising its functions";
  - "When using the services of a consultant with a view to obtaining information on market standards for remuneration systems, the compensation committee should ensure that the consultant concerned does not at the same time advise the human resources department or executive or managing directors of the company concerned."

In its July 2009 report on executive compensation and implementation of the AFEP/MEDEF recommendations, the AMF called on industry groups to take the European Commission's recommendations on compensation into account in their future work.

2.2. Domestic

2.2.1. Legislation concerning reporting on the functioning of the board of directors or supervisory board and changes occurring during the course of the year:

a)- Under Article L.621-18-3 of the Monetary and Financial Code, legal entities whose registered office is located in France and whose financial securities are traded on a regulated market are required to publish information relating to the subjects mentioned in the sixth, seventh and ninth paragraphs of Article L.225-37[8], the seventh, eighth and tenth paragraphs of Article L.225-68[9], and Article L.223-10-1 of the Commercial Code, as provided in the AMF's General Regulation.

Every year the AMF issues a report based on this information, which may include such recommendations as the AMF considers useful.

b)- Article L.225-37 of the Commercial Code was recently amended by the Act of 3 July 2008 and the Executive Order of 22 January 2009.

The chairman's report on internal control procedures should detail "those procedures which relate to drawing up and processing accounting and financial data for individual company accounts and, if applicable, for consolidated accounts".

"If a company voluntarily applies a corporate governance code drafted by industry groups, the chairman's report should identify any provisions it has chosen not to apply and give the reasons for doing so. The report should also state where the code can be consulted. If the company does not apply a corporate governance code, the report should indicate the rules that it applies in addition to the statutory requirements, and explain why it chose not to apply any of the provisions of this corporate governance code.

"The chairman's report should also describe the specific procedures relating to the participation of shareholders at general meetings, or provide a reference to the sections of the articles of incorporation that set out these mechanisms."

The chairman's report shall include "the publication of the information set forth in Article L.225-100-3[10]".

"The chairman's report shall be approved by the board of directors and made public".

c)- The Executive Order of 8 December 2008 transposed Directive 2006/43/EC on the annual accounts of certain types of companies, and amended the Commercial Code, and in particular Articles L. 823-19 and L. 823-20:

Article L.823-19 deals with audit committees:

The audit committee reports to the board of directors or supervisory board and is charged with "monitoring issues relating to drawing up and controlling accounting and financial reporting".

The composition of the audit committee is determined by the board of directors or supervisory board and should not include any executive members. "At least one member of the audit committee should have specific expertise

[8] For limited-liability companies with boards of directors.
[9] For limited-liability companies with management and supervisory boards.
[10] Article L.225-100-3 of the Commercial Code provides a list of the items to be explained if they are likely to have an influence on a public offering.

in financial or accounting matters, and be independent according to specific criteria that are made public by the management or supervisory body.”

The remit is as follows:

- the audit committee monitors:

  - the process for preparing financial reporting;
  - the effectiveness of internal control and risk management systems;
  - the statutory audit of annual accounts and, if applicable, consolidated accounts by the statutory auditors;
  - the independence of the statutory auditors;

- it makes recommendations on the appointment of the statutory auditors;

- it reports regularly to the board of directors or supervisory board.

Article L.823-20 of the Commercial Code exempts the following entities from the requirements mentioned in Article L.823-19:

- persons and entities controlled by the company within the meaning of Article L.233-16 of the Commercial Code, if the person or entity that controls them is itself subject to the provisions of Article L.823-19;
- the collective investment schemes referred to in Article L.214-1 of the Monetary and Financial Code;
- credit institutions whose securities are not traded on a regulated market and which have not continuously or repeatedly issued securities other than bonds, providing that the total nominal amount of these securities does not exceed €100 million and that no prospectus has been published;
- persons and entities having a body that exercises the functions of the specialised committee referred to in Article L.823-19, provided that this body (which may be either the management board or the supervisory board) is identified and its composition is made public.

NOTE: “The provisions of Article 14 of the Executive Order of 8 December 2008 will take effect eight months after the end of the first year beginning on or after 1 January 2008 in the course of which the term of office of the management board or supervisory board expires”.

For example, the creation of an audit committee becomes mandatory no later than 1 September 2009 for a company that falls within the scope of Article L.823-19, and for which the term of office of the management board or supervisory board expires during the course of the year ending 31 December 2008.

2.2.2. AMF General Regulation

Following the transposition of the Transparency Directive[11], the report on corporate governance and internal control is henceforth part of the ‘regulated information’ governed by Article 221-1 of the General Regulation of the AMF.

Article 221-1 provides that this ‘regulated information’ should include – in addition to the annual financial report, the half-yearly financial report, and quarterly financial reporting – the reports referred to in Article 222-9 of the General Regulation concerning the conditions for preparing and organising the work of the board of directors or supervisory board and the internal control “and risk management” procedures put in place by issuers.

The scope of application is limited to the reporting requirements referred to in Article L.226-10-1 of the Commercial Code for listed companies: limited liability companies and limited partnerships with share capital (*sociétés en commandite par actions*)[12].

[11] Resulting in an amendment to Title II of Book II of the AMF General Regulation, approved by the finance minister on 4 January 2007.

2.2.3. Amendment to the *Comité de la Réglementation Bancaire et Financière* (CRBF) regulation on internal control in banks

CRBF Regulation 97-02 of 21 February 1997 relating to internal control in credit institutions and investment firms was amended in January 2009 and again in May 2009 to reflect the impact of the financial crisis on the internal control systems of credit institutions and investment firms. These amendments strengthened the policies and procedures relating to risk management. Article 38 of Regulation 97-02 as amended states that, "in particular, the executive body and the decision-making body should receive appropriate reports on the evolution of the risks assumed by the subject institution. These bodies are required periodically to assess and control the effectiveness of policies, systems and procedures for complying with this Regulation, and to take appropriate measures to remedy any failures".

More specifically, the Order of 14 January 2009 amending Regulation 97-02 established the principle of reporting to governing bodies on the effectiveness of internal control and risk management systems and on the incidents reported by these systems. Criteria and materiality thresholds incidents identified by the internal control systems (Articles 17 ter and 38-1) should be set by the decision-making body and should trigger immediate reporting of material incidents to both the executive and the decision-making bodies. The Order also establishes an obligation to inform the Commission Bancaire of such incidents, and sets out the conditions for doing so.

The Order also seeks to ensure the proper execution of corrective measures ordered by internal and external auditors.

In addition to the provisions relating to risk management, the Order provides for the verification of the consistency between an institution's compensation policies and its risk management objectives (Article 5g). This aspect of the Order is a direct consequence of the financial crisis, which has shown that certain compensation policies contributed to excessive risk-taking.

On 21 October 2009 the Senior Supervisors Group published a report on risk management, assessing how weaknesses in risk management and internal controls contributed to industry distress during the financial crisis. According to the report, despite the progress made by financial market participants in improving risk management practices, there are still numerous underlying weaknesses relating to:

- governance: the failure of some boards of directors and senior managers of banks to adequately measure and assess the actual risks assumed by their institutions;
- risk control functions that have insufficient authority over front office functions;
- variable performance-based pay systems that do not take into account the risks or all of the costs generated by transactions;
- an information technology infrastructure that proved unable to aggregate risks speedily and exhaustively and to properly price complex products.

While the provisions discussed above apply only to financial institutions, common concerns have nevertheless emerged, particularly regarding risk management.

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[12] Article L. 226-10-1 also states that "when the financial securities of the company are traded on a regulated market, the chairman of the Supervisory Board should issue a report attached to the report called for in Articles L. 225-102, L. 225-102-1 and L. 233-26, which should include the information referred to in the seventh to ninth paragraphs of Article 225-68. This report should be approved by the supervisory board and should be made public".

3. Reference framework and practical guide

3.1. The AMF's reference framework for the internal control systems of listed companies and its application guide for small and medium capitalisation companies

In January 2007 the AMF published a reference framework for internal control systems, containing recommendations for companies on best practices and assessment methods, both for accounting and financial internal controls and for risk management. This framework was accompanied by an application guide intended mainly for small and medium capitalisation companies (small and midcaps), which contained general principles and key elements of analysis.

In January 2008 the AMF issued a statement recommending that companies in Segment A of Euronext Paris use this framework and that companies in the exchange's other two segments use a simplified application guide tailored to their size and structure.

3.2. Corporate governance code

- The AFEP/MEDEF code

In 2003 AFEP and MEDEF published recommendations concerning "principles of corporate governance". The recommendations were updated in 2007 and 2008 to incorporate new proposals, particularly in relation to compensation for executive directors of listed companies. This document is thus intended mainly for the boards of directors and supervisory boards of listed companies, and for their specialised committees.

In its 2008 report on corporate governance and internal control, the AMF encouraged "companies to apply the recommendations formulated by AFEP and MEDEF in their report on executive pay published in October 2008". The October 2008 report supplemented the recommendations published by AFEP/MEDEF in January 2007, the use of which the AMF had encouraged in its previous report.

On 9 July 2009 the AMF published a report executive compensation and implementation of the AFEP/MEDEF recommendations.

Finally, on 18 November 2009 AFEP and MEDEF published a report on implementation of the corporate governance code for listed companies, covering the year 2008. The report examines how companies in the SBF 120 and CAC 40 indexes have followed the AFEP/MEDEF recommendations on corporate governance (the roles of the board of directors or supervisory board, and the role of the committees) and on executive compensation[13].

- Other codes

MiddleNext has said it plans to publish a code of corporate governance designed for small and midcaps by the end of 2009. The AMF supports the principle of establishing such a code.

[13] See analysis on page 75.

3.3. COSO practical guide [14]

COSO has also produced an internal control framework. The original framework (COSO I) published in 1992 was extended in 2004 (COSO II[15]) to incorporate a risk management dimension. The framework, based on notions of internal control objectives and components, is used in implementing provisions relating to the Sarbanes-Oxley Act and similar legislation – a matter that concerns companies governed by US or French law.

3.4. Positions taken by the IFA

The French Institute of Directors (*Institut Français des Administrateurs* – IFA) has made several proposals relating to the role of independent directors, audit committees, and internal audit:

- The Independent Director: definition and analytic tables – Work of the IFA Commission on Ethics and the Status of Directors – 14 December 2006;
- Audit Committees – 100 best practices – January 2008;
- The role of internal audit in corporate governance (in collaboration with the *Institut Français de l'Audit et du Contrôle Internes*) – April 2009;
- The role of the director in risk management (in collaboration with the *Association pour le Management des Risques et des Assurances de l'Entreprise*) – June 2009.

3.5. Positions taken by the AFG

The French Association of Financial Management (*Association Française de la Gestion Financière* – AFG) has also participated in the efforts of French companies to construct a "sound corporate governance model", through the development of a reference text in 1998. In January 2009 the AFG updated its Recommendations on Corporate Governance, which are intended primarily as a guide for the exercise of voting rights in general meetings. The recommendations apply to companies whose shares are traded either on a regulated French market or on a multilateral trading facility.

[14] Committee Of Sponsoring Organizations of the Treadway Commission

[15] The discussion of risks in the COSO report published in 2004 – "*Enterprise Management Integrated Framework"* (commonly referred to as COSO II) – was aimed at identifying, assessing and managing risk, in contrast with COSO I, which dealt with internal controls.

II. CORPORATE GOVERNANCE

Listed companies are legally required to provide a statement on corporate governance in their annual report. This statement should indicate which corporate governance code, if any, the company voluntarily applies. As part of best practice, the statement should also explain which parts of the code are not applied and why this is the case.

It is recommended that companies refer to a code, because market standards are considered to include best practices. Some commentators even argue that applying a code enables companies to strike the optimal balance between "effective management, shareholder security and the longevity of the company[16]".

To ensure that shareholders are properly informed, listed companies must be transparent on this issue, providing disclosures through the chairman's report on the preparation and organisation of the board's work and the internal control procedures put in place by the company.

1. Organise the work of the board more effectively

1.1. Provide clearer information about due diligence and involvement of the chairman in drafting the report

1.1.1. Reminder of legislation and recommendations

- **Commercial Code**

Article L. 225-35:

"The board of directors determines the broad lines of the company's business activities and ensures their implementation. Without prejudice to the powers expressly invested in meetings of the shareholders, and within the limits of the company's purpose, it deals with all matters relating to the conduct of the company's business and decides all pertinent issues through its deliberations. The board of directors shall carry out the inspections and verifications which it considers appropriate. The company's chairman or chief executive is required to send all the documents and information necessary to perform this task to each director. "

Article L. 225-37:

"In companies whose financial securities are admitted to trading on a regulated market, **the chairman of the board of directors describes the preparation and organisation of the board's work** and the internal control and risk management procedures put in place by the company in a report attached to the report referred to in Articles L225-100, L225-102, L225-102-1 and L233-26. [...] The report provided for in this article is **approved by the board of directors** and made public."

- **AFEP/MEDEF Recommendations:**

In the case of companies with a dispersed ownership structure and no controlling shareholder, **half the board members** should be independent directors.

In the case of controlled companies, AFEP/MEDEF recommend that independent directors should make up **at least one-third of the board**.

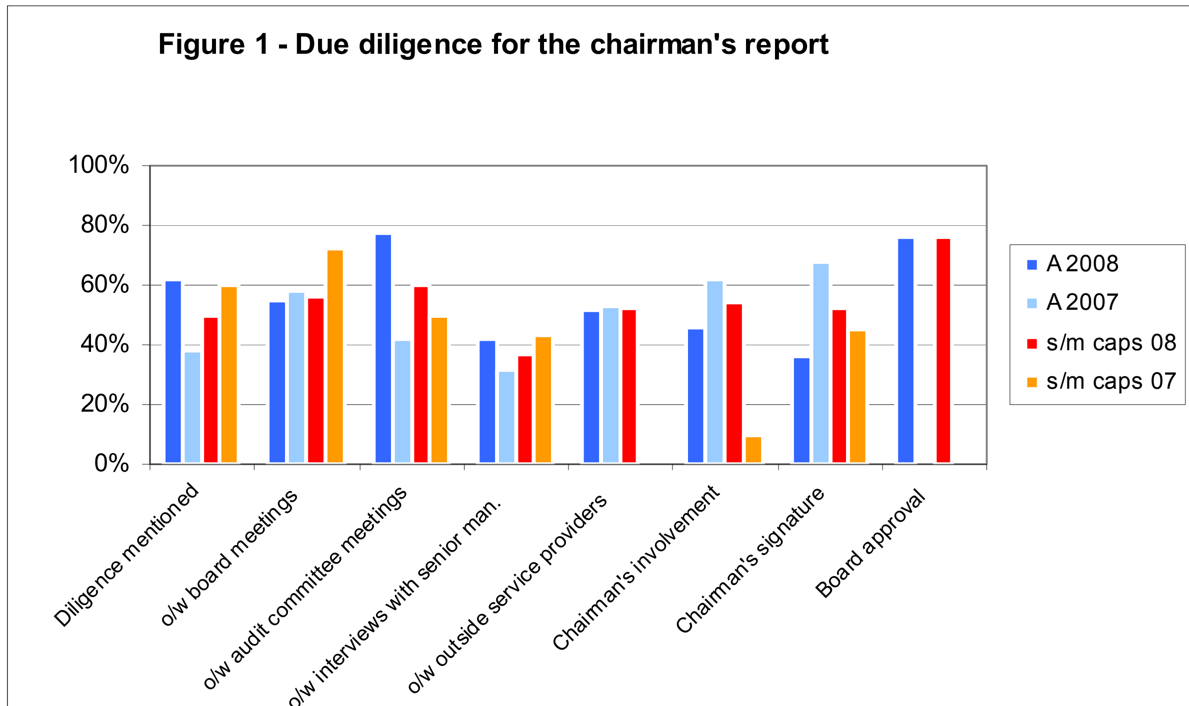
[16] D. Lebègue in *La gouvernance de l'entreprise familiale*. Vienot, Blondel, Colatrella, Gautier, Touraine. Ed. Eyrolles (2007).

1.1.2. Findings

The following activities are routinely mentioned among the due diligence tasks usually conducted as part of preparing the chairman's report: meetings of the board of directors or supervisory board, audit committee meetings, interviews with senior management and work by outside providers.

An analysis of the sample revealed the following developments in comparison with 2007:

- Companies in Segment A were more systematic in describing the due diligence that went into preparing the chairman's report; the same was not true for small and midcaps;
- Some types of due diligence were cited less often, such as board meetings or interviews with senior management. Others, however, were more widely mentioned, such as audit committee meetings or the use of an outside provider to prepare the chairman's report on internal control. Most reports analysed said that the board had, as required, approved the report:
- The involvement of the chairman does not necessarily mean that the chairman's signature is on the report.



Source: AMF
NB: Board approval of the report is a new requirement added to Article L. 225-37 of the Commercial Code, which is why the above figure does not include a comparison with 2007.

The AMF renews its recommendation on describing the due diligence done when preparing the report and the list of units, departments, and bodies concerned. For the sake of clarity, this description should preferably be presented in the introduction to the report

The AMF encourages companies to not merely list due diligence activities, but to provide a clear and detailed summary of the work carried out in this regard.

1.2. Organisation of the board's work

1.2.1. Board structures

As regards the organisation of the board, the proportion of companies with a board of directors (75% on average; 76% in the Segment A, 74% among small and midcaps) versus a supervisory board (25% on average; 24% in Segment A, 26% among small and midcaps) was basically the same as in 2007 (76% vs. 24%). That said, the proportion of small and midcaps with a supervisory board increased from 22% in 2007 to 26% in 2008.

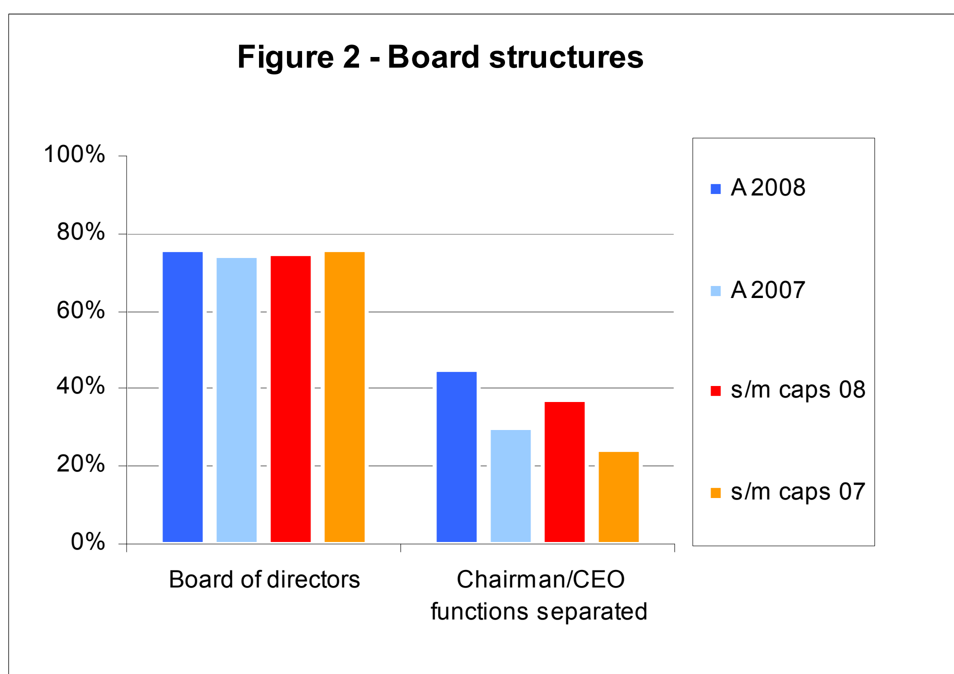
At the same time, the proportion of companies with a board of directors that had separated the roles of chairman and chief executive rose by 7 points in 2008 among companies in the Segment A (to 45%) and by 20 points among small and midcaps (30% in 2008). In the overall sample, 37% of companies opted to separate the two positions.

In 2009, however, a number of companies (including at least five in the CAC 40) chose to abandon their dual management board/supervisory board structure in favour of a board of directors.

The companies that made these changes justified them in terms of the desire to simplify and facilitate operational decision-making processes and the need to combine the functions of chairman and chief executive. One company in the sample gave this explanation: "In the current environment, the chief executive needs to have greater powers to be able to act swiftly, as circumstances dictate, without having to consult with a supervisory board or a board of directors".

Furthermore, in 2009, four Segment A companies with a board of directors combined the functions of chairman and chief executive. It is noteworthy that in the past companies couched the separation of chief executive and chairman functions in terms of striking a better balance between oversight and executive responsibility. Over the same period, three companies in the same sample reported that they were separating the functions of chairman and chief executive.

When companies change their governance arrangements, the AMF encourages them to:
- explain their decision;
- where applicable, indicate the provisions introduced by the company to prevent conflicts of interest (for example, appointment of a lead director).



Source: AMF

1.2.2. Composition of boards

Boards of directors and supervisory boards had an average of 10 directors, the same as in the previous year. On average, Segment A companies had more directors (13) than small and midcaps (7).

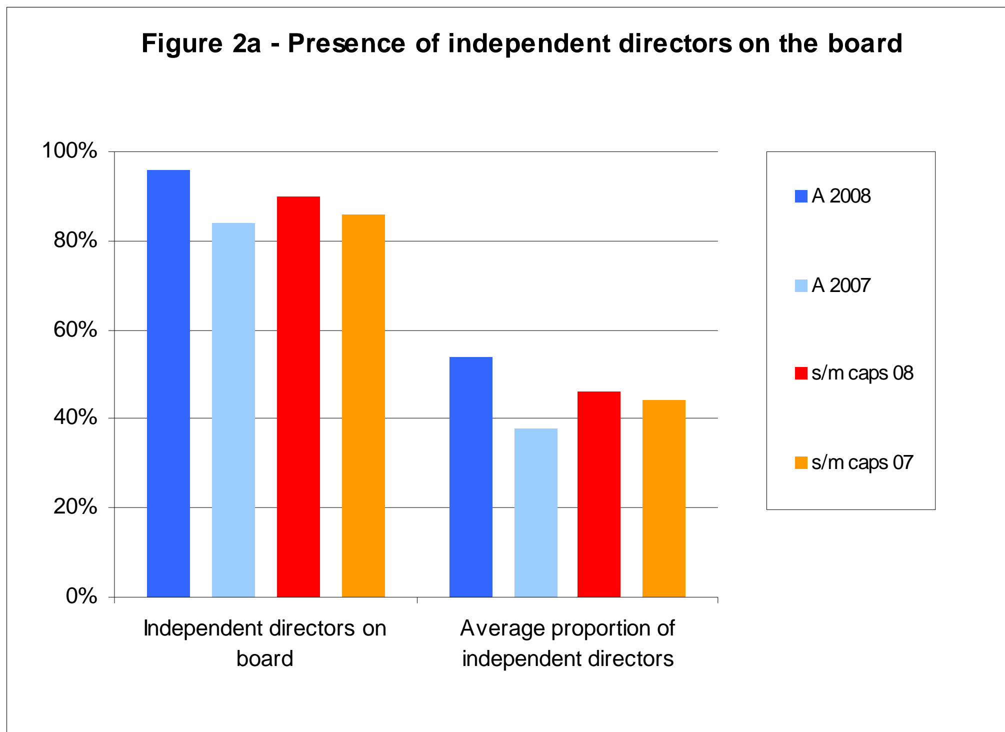
The average age of directors was 59 (57.5 among small and midcaps, 60 in the Segment A).

The number of companies with independent directors on the board was stable at around 96% in the Segment A and increased sharply among small and midcaps, from 76% to 84%. The average proportion of independent directors on the boards of companies in the sample was 46%.

However, this ratio varied depending on the segment. On average, Segment A companies had a ratio of independent directors to total directors of 54%, unchanged from 2007 and above the AFEP/MEDEF recommended ratio of 50%.

Among small and midcaps, however, the average proportion of independent directors was 38%. This may be linked to the fact that, compared with Segment A companies, small and midcaps are on average more often controlled companies[17].

[17] A MiddleNext study of SBF 250 companies released on 1 July 2009 shows that ownership structures tend to be more concentrated among small and midcaps. A full 73% of these firms have one shareholder who owns at least 20% of the capital, and in 47% of cases, this shareholder owns at least 50% of the capital.

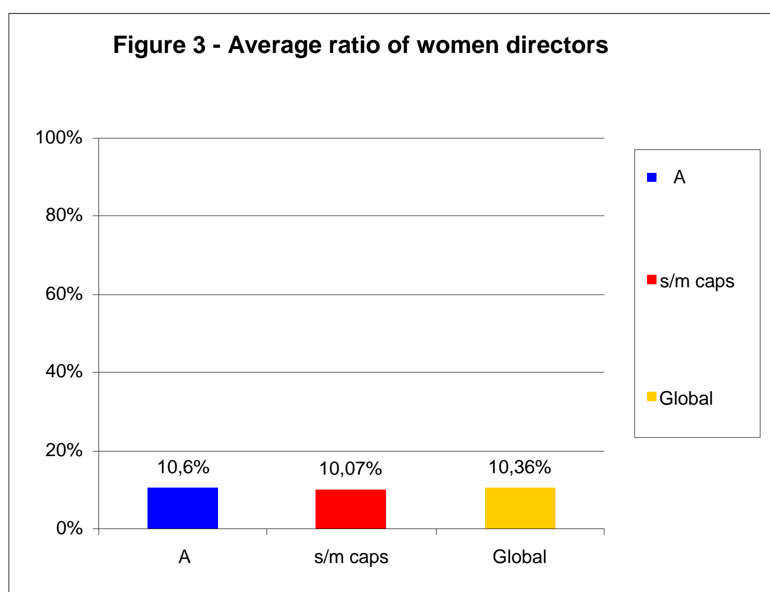


Source: AMF

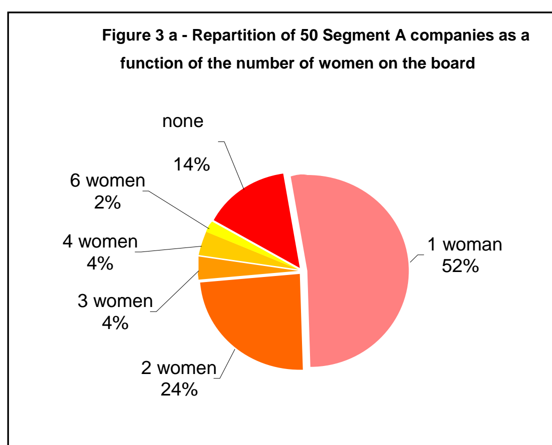
The percentage of women on boards of directors or supervisory boards was 10.4% in the overall sample, 10.6% in the Segment A (working out to 1.3 women), and 10.1% among small and midcaps (0.7 women).

In Segment A, 52% of boards have one woman director and 24% have two. In all, 14% of Segment A boards are made up exclusively of men.

Among the boards of small and midcaps, 46% comprise exclusively men, 38% include one woman director, and 12% include two women.



Source: AMF



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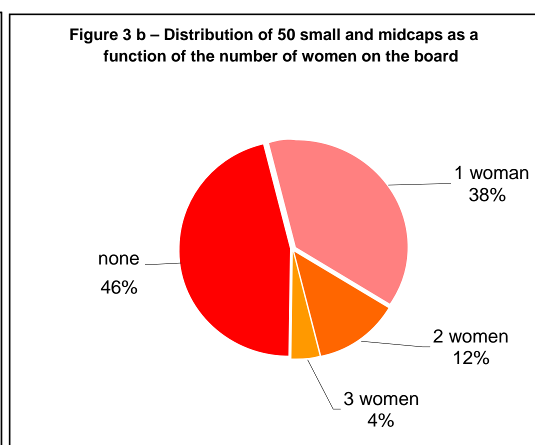


Source: AMF

1.3. Multiple directorships in listed companies held by executive directors and non-executive chairman

1.3.1. Reminder of legislation and recommendations

- Commercial Code

The Commercial Code (Article L. 225-21) establishes a precise legal regime for the exercise of directorships. The main elements are as follows:

- no natural person shall concurrently hold more than five directorships of companies having their registered offices in France;

- however, there are exemptions, such as directorships in the same group within the meaning of Article L. 233-16 of the Commercial Code, which only count as one directorship, or directorships with foreign companies;

- as regards enforcement of the provisions of this article, directorships of companies whose securities are not admitted to trading on a regulated market and that are controlled within the meaning of Article L. 233-16 by the same company shall count as one directorship, provided that the number of such directorships does not exceed five.

- AFEP/MEDEF recommendation

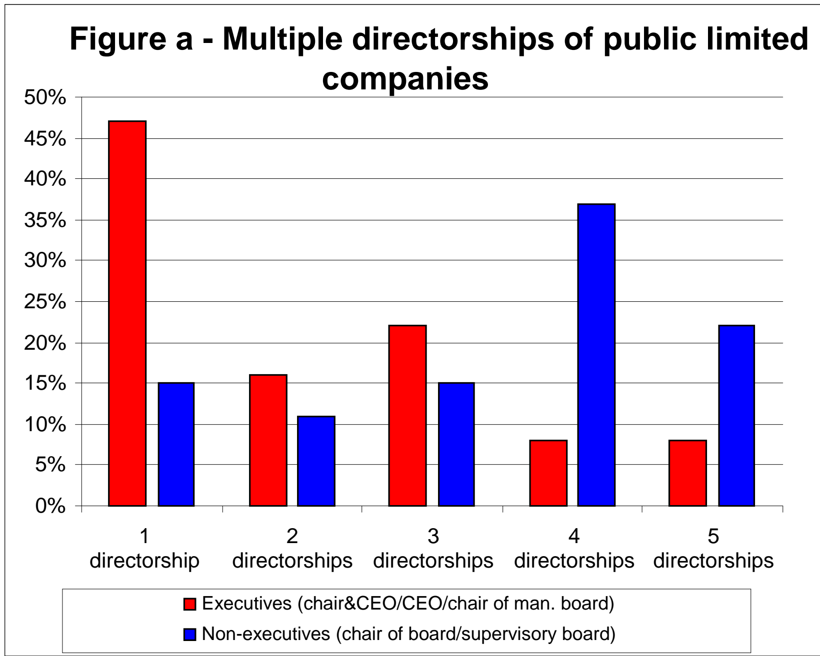
"The director should devote the necessary time and attention to his functions. If he has executive duties, he should not in principle agree to hold more than four other directorships in listed companies, including foreign companies, outside his own group.

1.3.2. Findings

The following was found concerning Segment A companies in the sample:

- as regards non-executive chairmen (chairman of the supervisory board and chairman of the board of directors when the positions of chairman and chief executive are separate) and
- executive directors (executives excluding members of the management board: chief executive, chairman of the management board, chairman & chief executive), all the companies analysed complied with Article L. 225-21 of the Commercial Code.

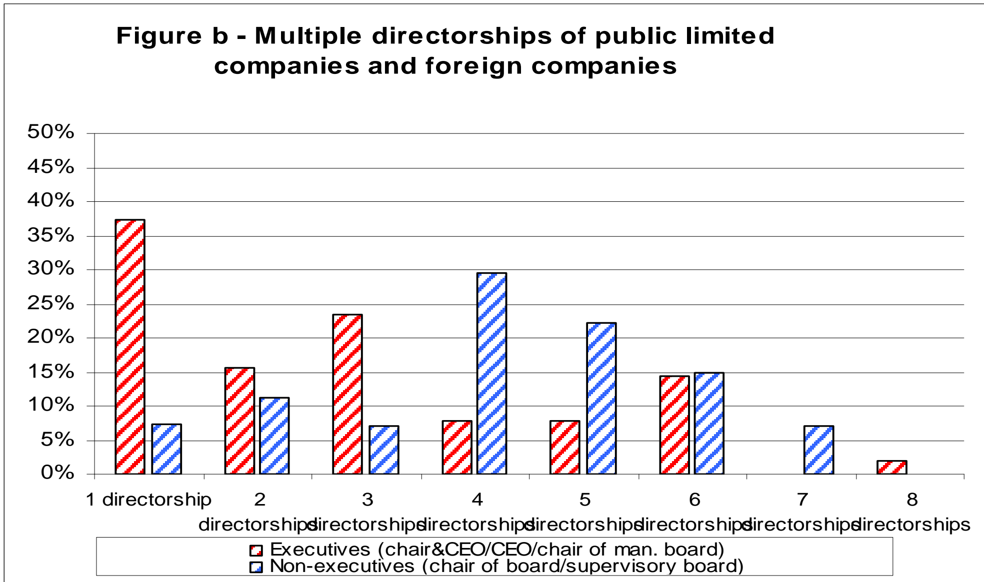
Generally speaking, executive corporate officers often hold just one directorship (48%), while around 40% of non-executives hold four directorships[18].



Source: AMF

However, some directors also hold directorships in foreign listed companies (figure b below). These positions may be demanding and require significant involvement on the part of the director. While this possibility is allowed by law, note that in 2008 in the same sample, four executives held more than five directorships, even though AFEP/MEDEF recommend that they should not "in principle agree to hold more than four other directorships in listed companies, including foreign companies".

Although this recommendation does not apply to non-executive chairmen, we nevertheless note that six of them held more than five directorships, taking into account directorships with foreign listed companies.



Source: AMF

[18] For the record, the French Institute of Directors (IFA) suggests that when a director holds executive responsibilities in a listed company, he should not hold more than two other directorships in listed companies, not counting subsidiaries of the group.

1.3.3. Diversifying the composition of boards, and ways to increase women's representation in the boardroom (illustrative estimate)

When considering the following illustrative estimate[19], which assumes that all directorships that become open as indicated go to women, readers should keep in mind that this is a purely statistical investigation forming one facet of the overall debate on choosing corporate governance structures.

Consider the following illustrative estimate:

(1) stricter limits on the holding of multiple directorships by executive directors;
(2) systematic separation of the functions of chairman and chief executive;
(3) stricter limits on the holding of multiple directorships by non-executive chairman.

1) Stricter limits on the holding of multiple directorships by CEOs, chairmen/CEOs and management board chairmen:

- Chief executives: placing a limit of one directorship (compared with an average of 1.4) would free up four directorships;
- Chairmen/chief executives: placing a limit of one directorship (compared with an average of 3) would free up 43.7 directorships.

2) Separating the functions of chairman and chief executive

Separating the functions of chairman and chief executive (55% of the sample of Segment A companies) would free up 27 directorships.

3) Even if chairmen of the board are non-executives, limits could still be placed on the number of directorships they hold

- Chairmen of the board of directors: placing a limit of one directorship (compared with an average of 3.4) would free up 40.8 directorships;
- Management board chairmen: placing a limit of one directorship (compared with an average of 1.8) would free up eight directorships;
- Supervisory board chairmen: placing a limit of one directorship (compared with an average of 3.5) would free up 25 directorships.

Based on these statistics, the restrictions described above would make 149 directorships available, bringing the ratio of women on corporate boards to 31% (compared with 10.6% at end-2008) among Segment A companies. This example illustrates the effort that would be needed to reach a ratio of around 30% to 40%, without taking into account the effects of regular re-elections.

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[19] Estimate based on 650 directors (13 members on average for the 50 companies in Segment A): the number of directorships held by women should be increased to 260 (195 more than the 65 held at the end of 2008).

The AMF notes that companies often provide details about the companies in which directors hold directorships (group companies, foreign or unlisted firms). The AMF repeats its 2007 recommendation, particularly as regards information on whether these companies belong to the same group.

Furthermore, given the increased powers assigned to the board of directors (especially to their committees), the complexity of organisations and the economic environment, the role of director is becoming ever more demanding. Accordingly, companies should pay particular attention to complying with – or explaining non-compliance with – the AFEP/MEDEF recommendation on multiple directorships, especially as regards executive directors and the chairmen of boards of directors or supervisory boards.

In addition, the AMF recommends that companies consider the question of appointing women with equivalent skills. On this matter, limiting the number of multiple directorships is one way of potentially increasing the presence of women in the boardroom within a reasonable timeframe.

1.4. Tasks and activity of the board

- *Tasks of the board*

As in 2007 a high number (94%) of companies mentioned the tasks of the board. However, only 53% of companies (the same among Segment A firms and small and midcaps) provided a detailed description of these tasks.

The following explanation is an example of best practice:

Good practice: "It [the board] determines the strategy and broad lines of the company's business and ensures that these are implemented, decides whether to combine or separate the offices of chief executive and chairman of the board, appoints corporate officers, sets any limits on the powers of the chief executive, approves the chairman's draft report, carries out such inspections and verifications as it considers appropriate, supervises management and the accuracy of the financial statements, examines and rules on the financial statements, and provides high-quality financial reporting to shareholders and markets".

For information, the following description is not sufficiently detailed:

Less good practice: "The board deals with all matters relating to the conduct of the company's business and decides all issues concerning the company through its deliberations".

- *Frequency of board meetings*

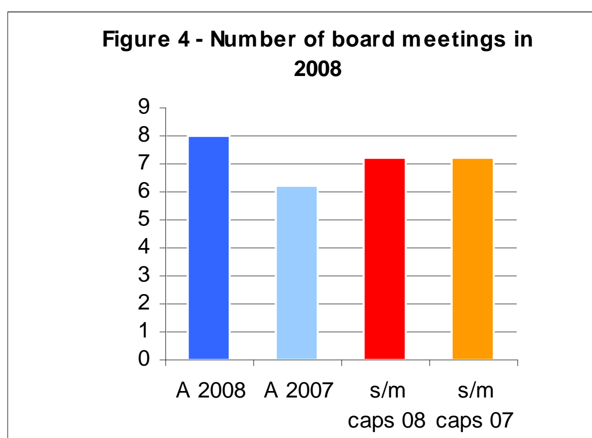
According to the AFEP/MEDEF framework, "the number of meetings of the board of directors and meetings of the board's committees over the course of the previous year should be indicated in the annual report, which should also provide shareholders with relevant information about directors' attendance of these meetings. The frequency and length of board meetings should be sufficient to allow an in-depth examination and discussion of matters coming within the board's remit".

In its 2008 report on corporate governance and internal control, the AMF called for widespread adoption among companies of the practices of preparing a detailed report on the board's activity and of disclosing the subjects discussed at board meetings. The AMF also recommended that companies disclose directors' average rate of attendance at board meetings.

The average number of board meetings held in the year was around 7 among small and midcaps, and increased from 6 to 8 in the Segment A.

The attendance rate of directors at board meetings increased by 6 points to 88% between 2007 and 2008 in the Segment A. Among small and midcaps, the rate was steady at around 85%.

The proportion of companies providing a detailed account of the subjects discussed at board meetings was 80% in 2008 in Segment A, up from 72% in 2007, and 77% among small and midcaps, or 8 points higher than the previous year.



Source: AMF.

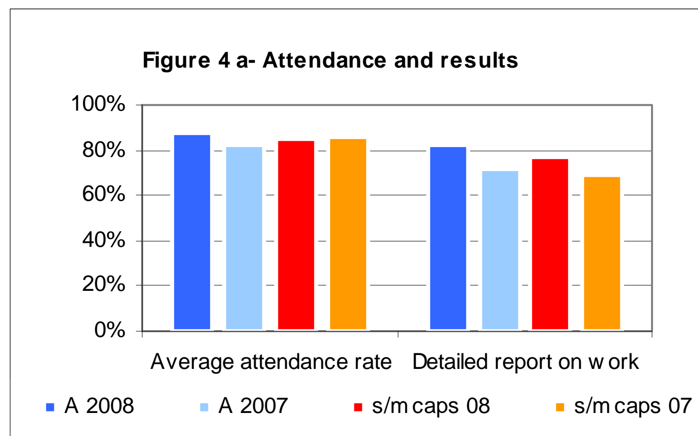
- *Reporting on the board's work*

The following good practices were observed in terms of detailed reporting on the board's actual work:

- Monitoring day-to-day management: quarterly activity reports, accounts, distribution policy, committee reports, reports on acquisitions, disposals and major deals, review of parent company documents, preparation of annual general meeting.

- Monitoring of broad lines: shareholder policy, promotion of employee share ownership, group development strategy, financial management during crisis, corporate governance rules.

- Operation of governing bodies: appointments, employment contract/corporate office of chairman/chief executive, application of 2008 AFEP/MEDEF recommendations on compensation (short- and long-term incentives, pension regime, benefits, unemployment insurance of senior executives and managers, pension loss compensation benefits), shareholding requirements. Composition of board and evaluation.



Source: AMF

The AMF recommends that companies that do not yet do so provide precise details to clarify the tasks of, and work actually done by, the board.

The number of companies that prepare a report on the work of the board is increasing. Even so, as it did last year, the AMF calls on companies generally to adopt this practice and to disclose the subjects discussed at board meetings.

The AMF also recommends that the handful of companies (eight in the 2008 sample) that do not yet do so should disclose directors' attendance rates at board meetings.

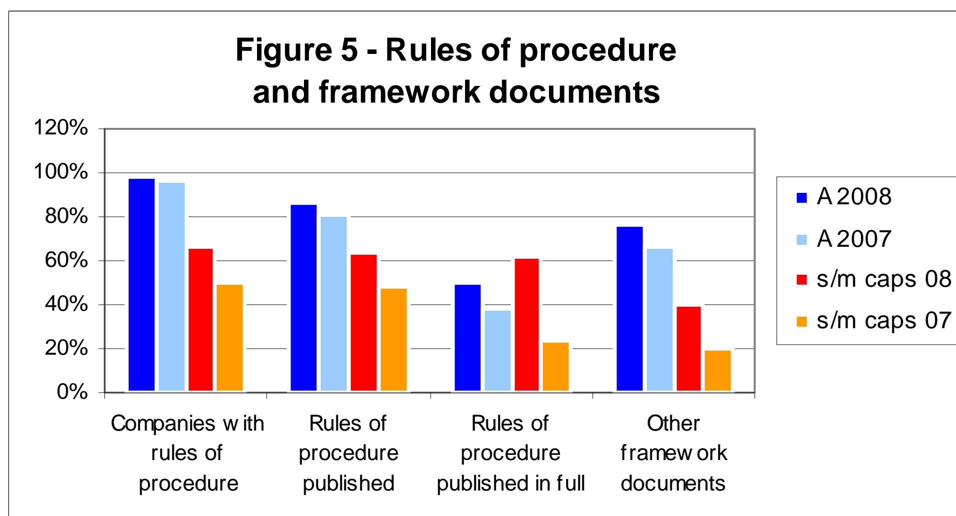
1.5. Rules of procedure

The number of companies that have rules of procedure is increasing steadily, particularly among small and midcaps. Furthermore, these rules are being made more publicly accessible, generally by being put online, included in the registration document or made available on request at the company's head office. However, not all companies publish their rules of procedure in full.

Rules of procedure are published:

- in full in 54% of cases (50% in the Segment A, 62% among small and midcaps);
- as excerpts in 40% of cases (40% in the Segment A, 33% among small and midcaps);
- in summary form in 6% of cases (7% in the Segment A, 5% among small and midcaps).

Companies, particularly those in the Segment A, supplement their rules of procedure with other framework documents, including charters or codes of good practice, directors' charters and environmental charters.



Source: AMF

Small and midcaps have made noteworthy efforts in this regard. The number of such companies to publish their rules of procedure in full has tripled compared with last year.

In general, the rules of procedure constitute an extremely important document that describes the operating procedures, powers, responsibilities and tasks of the board and its specialised committees, and may establish the principle of evaluating the board's operation.

The AMF believes that publishing the full rules of procedure in an accessible way, for example online, would have many benefits for listed companies in terms of transparency.

The AMF also recommends that the rules of procedure of the board should be regularly reviewed and, if necessary, supplemented or modified to reflect regulatory conditions.

1.6. Restrictions placed on the powers of the chief executive and his representatives

1.6.1. Reminder of legislation and recommendations

Art. L. 225-37 of the Commercial Code: "without prejudice to the provisions of Article L225-56, the said report also indicates any limitations the board of directors places on the powers of the chief executive".

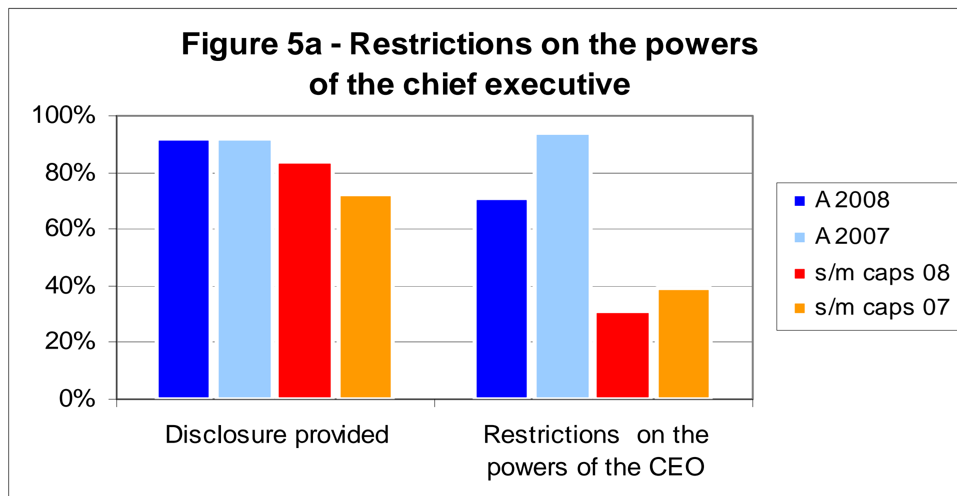
Art. L. 225-56 of the Commercial Code, sub-paragraph 2: "with the agreement of the chief executive, the board of directors shall determine the scope and the term of the powers conferred upon deputy chief executives".

1.6.2. Findings

An analysis of the sample reveals that a growing number of small and midcaps report on whether restrictions have been placed on the chief executive's powers. Around 10% of companies in the total sample, i.e. all segments, did not provide a disclosure on this question.

Of those that did provide information, 71% of companies in the Segment A and 31% of small and midcaps limit the powers of their chief executive. These are smaller proportions than last year and may be attributable to the financial crisis, which prompted some companies to concentrate authority.

Restrictions mainly apply to decisions on major issues, such as investments, disinvestments or debt/disposal transactions over a level set by the board of directors, setting up in or withdrawing from certain geographical areas, securities issuance, and so on.



Source: AMF

The AMF encourages companies to place restrictions on the powers of the chief executive, whether or not he is also the chairman of the board, as well as on the powers of his representatives.

Furthermore, the AMF repeats its recommendation that all restrictions on the powers of the chief executive and his representatives resulting from rules of procedure and/or practices should be systematically disclosed in the report. If these restrictions have been adopted officially, the report should provide a cross-reference to the rules of procedure, provided these are publicly accessible

If no restrictions are in place, this fact should be mentioned.

However, the AMF considers that placing restrictions on the powers of the chief executive and his representatives is good practice. It encourages companies to introduce restrictions if there are none, to maintain and strengthen existing restrictions, and to make restrictions transparent by publishing them in the rules of procedure.

2. Clarify reference to a corporate governance code

2.1. Reference to a corporate governance code

2.1.1. Reminder of legislation and recommendations

- Commercial Code

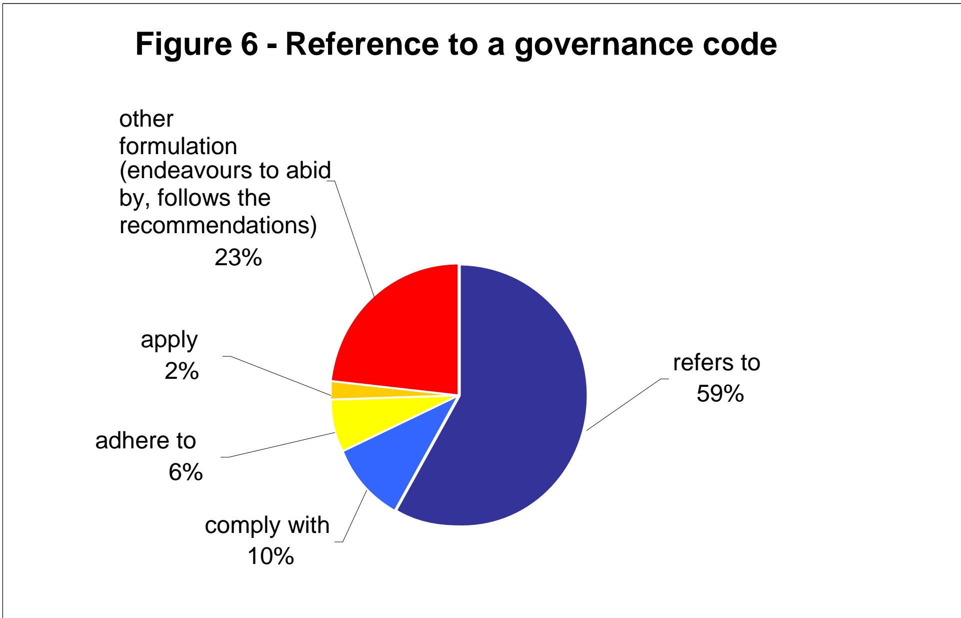
Art L. 225-37 of the Commercial Code: "When a company voluntarily refers to a corporate governance code developed by a professional association, the report provided for in this article shall also identify the provisions that have been rejected and the reasons for doing so, as well as where the code may be consulted. If a company does not make reference to such a corporate governance code, the report shall indicate the rules that it applies in addition to statutory requirements, and explain why the company has decided not to apply this corporate governance code".

2.1.2. Findings

In all, 81% of companies in the sample said that they had used the AFEP/MEDEF corporate governance code as a basis when preparing the chairman's report. However, practices vary across segments, with the proportions standing at 94% in Segment A compared with 68% among companies in Segments B and C.

This lack of uniformity is further accentuated by the language used by companies when referring to the code. The terminology used in Article L. 225-37 of the Commercial Code is precise: companies should refer to a corporate governance code. The use of the term "refer to" makes it possible to say with accuracy whether companies apply the code.

Furthermore, when the expression "refer to" is used, the reference to a code is clearly established, enabling companies to apply the "comply or explain" principle within a standardised framework.



The AMF notes that companies employ different terminologies when talking about their use of a reference framework. The AMF recommends that companies use the language given in the Commercial Code, and particularly the expression "refer to", or, if necessary, other unambiguous terms such as "apply" or "comply with". It believes that companies should avoid using expressions such as "endeavours to abide by".

When companies speak about gradually coming into compliance, the AMF suggests that they provide details about the planned stages (e.g. creation of an audit committee).

2.2. Use of the "comply or explain" principle

The good practices recommended in the AFEP/MEDEF code as regards referring to a code are as follows: "listed companies that refer to this corporate governance code should give a precise account in their registration document or annual report concerning the application of these recommendations and, if they choose not to apply certain recommendations, explain the reasons for this". This is the "comply or explain" approach. To promote transparency, companies should also say where the code may be accessed.

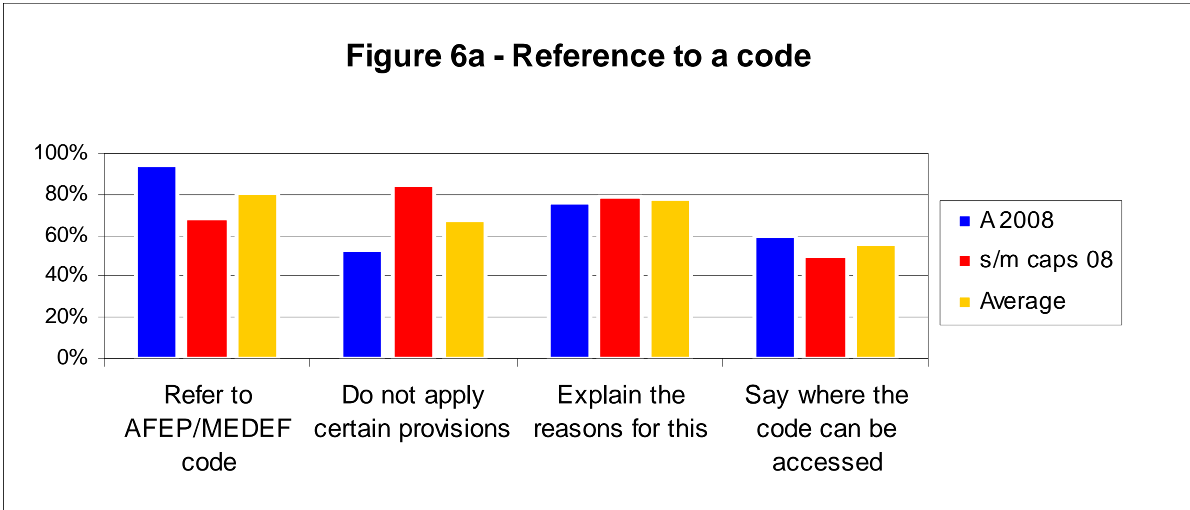
While 81% of companies cited the AFEP/MEDEF code as their reference for corporate governance, 67% of them said that they had not applied some of the provisions. This proportion was higher among small and midcaps, 85% of which stated that they did not apply certain provisions, compared with 53% of Segment A companies.

Moreover, among companies citing the AFEP/MEDEF code, over 20% (all segments combined) did not uphold the "comply or explain" principle, in that they provided no explanation for their partial compliance.

In addition, over 40% of companies in the sample did not say where the code may be accessed, even though this information is mandatory under Article L. 225-37 of the Commercial Code.

The provisions that companies most often chose not to apply included the following:

- the four-year limit for terms of office;
- the fact that, to be independent, a director cannot have been a director of the company for more than 12 years;
- the proportion of independent directors on the board or its committees.



Source: AMF

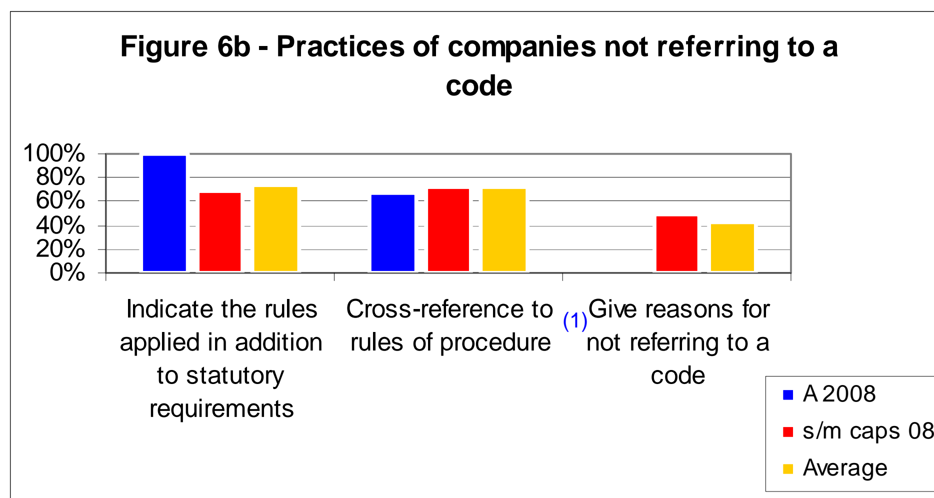
Reminder: if companies do not apply one or more provisions of the code to which they refer, they are required by law to highlight these criteria and to give reasons for their decision, in order to satisfy transparency and "comply or explain" requirements.

2.3. Companies that do not refer to a code

If companies do not refer to a corporate governance code, they must indicate the rules that they apply in addition to statutory requirements.

Within the sample, 6% of companies in Segment A (three companies) did not refer to a corporate governance code. However, all these companies indicated the additional rules that they apply in the area of corporate governance. Two of the companies did this by providing a cross-reference to their rules of procedure. By contrast, none of these three companies justified the decision not to refer to a code.

Among small and midcaps, 32% (16 companies) did not refer to a corporate governance code. Of these 16, 70% indicated the additional rules that they apply and three-quarters of them did this through a cross-reference to the rules of procedure. Eight of the 16 companies did not justify their decision not to refer to a code.



Source: AMF

(1) Of the 3 Segment A companies that did not refer to a code, none (0%) gave a reason for this decision.

If a company chooses not to refer to a market standard on corporate governance, it must by law give the reasons for this decision and indicate the rules applied in addition to statutory requirements.

3. Define director independence more effectively

3.1. Information about independent directors

3.1.1. Reminder of legislation and recommendations

Since the Executive Order of 8 December 2008 was passed, the Commercial Code has included in Article L.823-19 a requirement for all listed companies to set up an audit committee with at least one independent director.

- AFEP-MEDEF definition of director independence

A director is independent when he has no relationship of any kind whatsoever with the company, its group or its management that could compromise his free judgment. In other words, an independent director is understood to be not only a non-executive director, i.e. one not performing management duties in the company or its group, but also one devoid of particular bonds of interest (significant shareholder, employee, other) with them. Among other things, this means he or she should not:

- be an employee or corporate officer of the company, nor an employee or director of its parent or of one of its consolidated subsidiaries, and should not have been one in the previous five years;
- be a corporate officer of a company in which the company holds, either directly or indirectly, a directorship, or in which a directorship is held by an employee of the company designated as such or by a current or former (going back five years) corporate officer of the company;
- be a customer, supplier, investment banker or commercial banker
  - of material importance to the company or its group;
  - or for which the company or its group represents a material proportion of the entity's activity;
- have any close family ties with a corporate officer of the company;
- have been an auditor of the company over the past five years;
- have been a director of the company for more than 12 years.

3.1.2. Findings

- 90 out of 100 companies reported having independent directors on their board of directors or supervisory board;

- of the 10 companies that did not report having independent directors, two referred to special circumstances that meant the appointment of independent directors companies was not relevant (state-owned or partly state-owned company, staff representatives, etc.). The other eight companies were small or midcaps;

- of the 90 companies that reported having independent directors, 80 (89%) companies gave a definition of director independence; of these, 76 (95%) referred in their definition to the criteria of the AFEP/MEDEF code, while four (5%) gave another definition.

Table 1 - Other definitions given for independent directors	
Eurolist segment	**Definition**
A	Anyone who is not in a situation that might affect their free judgement or place them in a real or potential conflict of interest.
B	Independent means that board members do not receive any compensation other than directors' fees from the company or from a group company.
B	Non-membership of the family group and no particular ties to the company/group.
C	Does not have and has not had in the last five years a significant interest in the capital of the company and has not held any operational function within the company over the same period (the company stresses that it does not refer to the AFEP/MEDEF code, although it complies with some principles).

Source: AMF

3.2. Detailed information about the definition, compliance with the definition and application of the comply or explain principle

Supporting references for the criteria used to define director independence varied among the 76 companies that said they had referred to the market standard. Four types of practice were identified:

- **Best practice.** Companies give a transparent, detailed list of the criteria of the AFEP/MEDEF code. They do not omit any of the criteria.
    - **Around one-quarter (24%) of the 76 companies fell into this category.**

- **Good practice.** Companies give the general definition of independence provided in the AFEP/MEDEF code or the detailed list of the code's criteria. They exclude some criteria, giving a clear and transparent explanation for this.
    - **38% of the 76 companies fell into this category**.

    These included:

    - 19 companies that gave the general definition of independence provided in the AFEP/MEDEF code [20] and said that they did not omit any of the criteria;
    - 5 companies that referred to this definition and gave reasons for omitting some of the criteria;
    - 3 companies that provided the complete list of AFEP/MEDEF criteria and gave reasons for omitting some of the criteria;
    - 2 companies that merely provided a list of the criteria that they complied with and gave reasons for omitting the other criteria.

[20] A director is independent when he has no relationship of any kind whatsoever with the company, its group or its management.

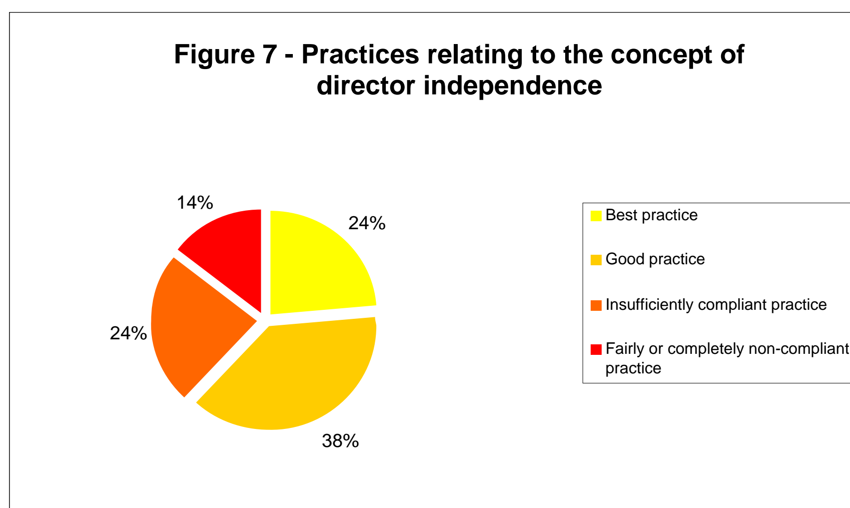
- **Insufficiently compliant practices:** Companies simply refer to the AFEP/MEDEF code without providing details of the criteria or the extent of their compliance. Reasons are given for omitting certain criteria, but the lack of a reference to the complete definition of the AFEP/MEDEF code makes it impossible to determine compliance (full or partial) with the code.

    - **24% of the 76 companies fell into this category**.

- **Fairly or completely non-compliant practices. Companies** omit certain criteria from the AFEP/MEDEF definition without providing reasons for this.

    - **14% of the 76 companies fell into this category.**

To the last category must be added four companies that opted for a different definition from that provided in the AFEP/MEDEF code: these companies used non-specific criteria to define director independence (cf. Table 1).



Source: AMF

Furthermore, our analysis of company reports revealed the following cases, which raise serious questions :

- one company described a director as independent even though he was the senior manager of the company's main shareholder;
- one company described a director as independent even though he was described as a non-independent director on the board of the company's controlling entity;
- one company described a director as independent even though he was a corporate officer of one of the company's banks. In addition to these financial relations, the bank and the company had business ties that could impact the bank's creditworthiness.

The AMF repeats its recommendation to detail compliance with the criteria used by the AFEP/MEDEF code to define director independence, to list all the criteria and, if the company does not apply certain of the code's criteria, to provide precise reasons for this. This point is even more important because Article L. 823-19 of the Commercial Code now makes it obligatory to have at least one independent director with special financial or accounting skills on the audit committee.

3.3. Director independence and compensation arrangements

3.3.1. Reminder of legislation and recommendations

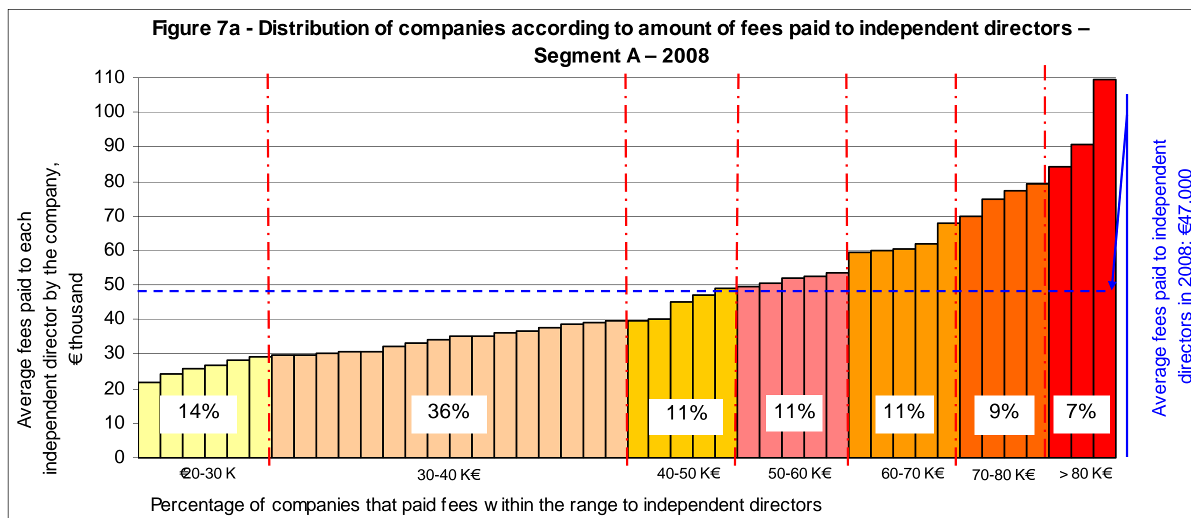
- AFEP/MEDEF code

The AFEP/MEDEF code recommends reporting "the aggregate and individual amount of directors' fees". It also recommends describing "the rules for allocating" directors' fees and says that the "method of allocation of compensation [...] should take account, in such ways as it [the board] shall determine, of the directors' attendance at meetings of the board and committees, and therefore include a variable portion. It seems natural that the directors' attendance at meetings of specialised committees should be rewarded with an additional amount of directors' fees".

3.3.2. Findings

As regards the 50 companies in Eurolist Segment A, the following was found:

- average directors' fees paid in Segment A companies were €47,000;
- 61% of Segment A companies paid directors' fees of less than €50,000;
- 32% of Segment A companies paid directors' fees of between €50,000 and €70,000;
- 7% of Segment A companies paid directors' fees of more than €70,000.



Source: AMF

Furthermore, among companies that paid directors' fees of more than €70,000, there were wide variations in the individual fees paid (up to €234,000).

These variations result from a number of factors, including:

- directors' attendance rates or means of attending board meetings;
- membership of one or more specialised committees and attendance of committee meetings;
- chairmanship of the supervisory board;
- chairmanship of a specialised committee.

However, the rules for allocating fees vary considerably from one company to another, even if the principles for setting fees are broadly the same.

Furthermore, if the fees paid to a few directors are significantly higher than the average fees paid by the company, a close examination should be conducted of directors' independence in the light of the amount of fees received.

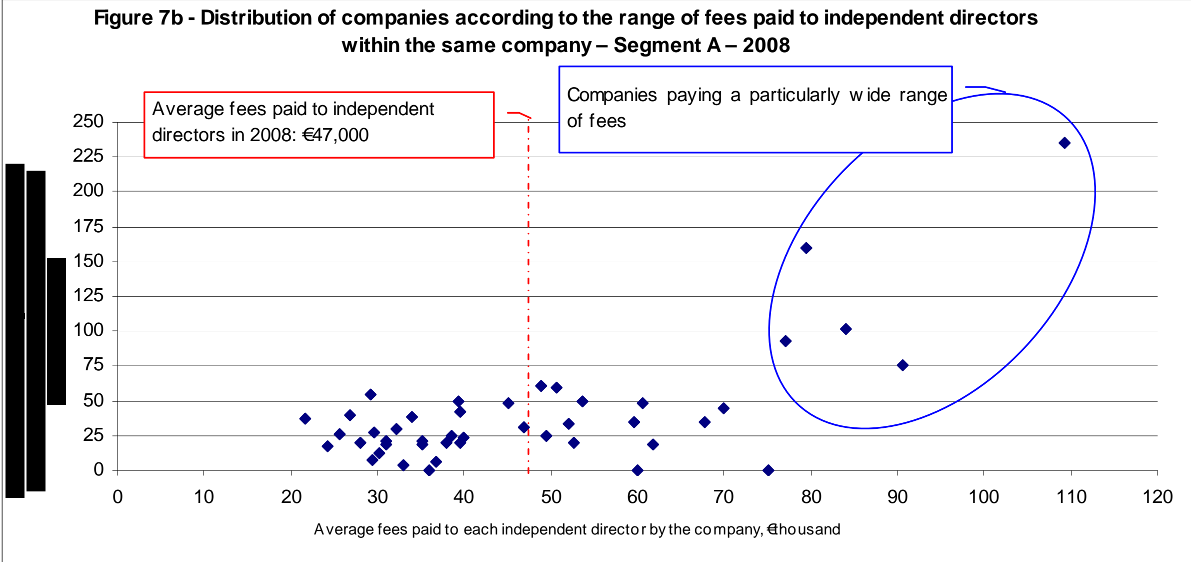


Figure 7b - Distribution of companies according to the range of fees paid to independent directors within the same company – Segment A – 2008

Source: AMF

4. Clarify and strengthen the role of specialised committees

4.1. Specialised committees

4.1.1. Framework

The board may set up specialised committees to help it perform its various tasks. None of these committees is legally required, except for the audit committee, which has been mandatory since the Executive Order of 8 December 2008 was passed.

However, the AFEP/MEDEF code provides that: "the number and structure of the committees are determined by each board". It further recommends that the following areas should be subject to preparatory work by a specialised committee of the board of directors:

- review of accounts;
- monitoring of internal audit;
- selection of statutory auditors;
- compensation policy;
- appointments of directors and executive directors.

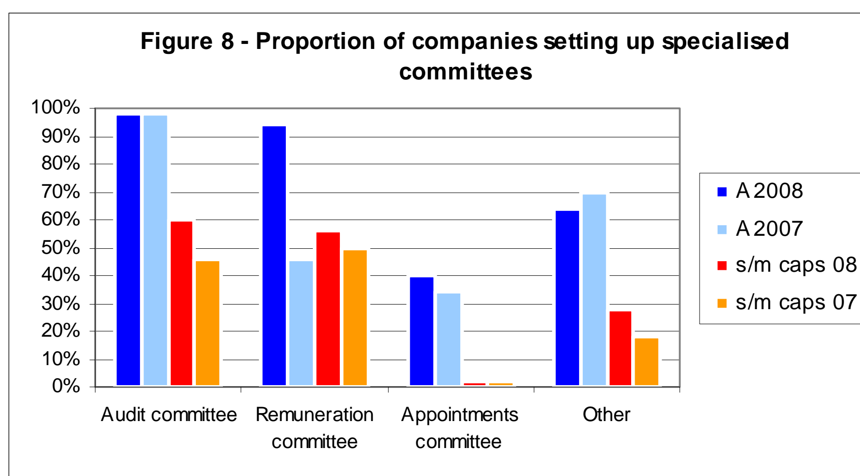
4.1.2. Findings

As the following figure shows, boards are tending to set up more specialised committees. For example, the proportion of small and midcaps to have created an audit committee rose sharply, climbing by 14 points from 46% to 60%.

Similarly, more companies are setting up compensation committees. Small and midcaps are tending to combine this committee with an appointments committee (the AFEP/MEDEF code says that the appointments committee "may or may not be separate from the compensation committee"). In addition, in the Segment A, there was a 48-point jump in the proportion of companies that had a compensation committee, probably in connection with implementation of the AFEP/MEDEF recommendations on executive pay[21].

Just 50% of companies gave details of interactions between the board and its committees, although this number concealed sharply contrasting situations among Segment A companies (76%) and small and midcaps (24%).

[21] Cf. AMF 2009 report on executive compensation and implementation of the AFEP/MEDEF recommendations.



Source: AMF

For the most part, companies that had other specialised committees mentioned strategy committees (26 companies), especially in the Segment A (more than 40% of companies in this segment had one). Other, less common, specialised committees address ethics (8) or the management of risk/exposures (7 risk committees).

Table 3 – Other specialised committees		
Euronext	**A**	**B&C**
Strategy or equivalent	21	5
Internal control	3	
Ethics/social responsibility	6	2
Scientific (or technological)	1	2
Risk/exposures/investments	5	2

Source: AMF

4.2. Audit committee

4.2.1. Reminder of legislation and recommendations

- *Requirement to set up an audit committee*

The Executive Order of 8 December 2008 introduced the requirement for entities whose shares are admitted to a regulated market to set up an audit committee. The role of this specialised committee is to monitor issues relating to the preparation and review of accounting and financial information. The audit committee acts exclusively under the joint responsibility of the members of the board of directors or supervisory board, as appropriate.

- *Composition*

Article L. 823-19 of the Commercial Code: "In entities whose securities are listed on a regulated market, [...] a specialised committee acting exclusively under the joint responsibility of the board of directors or the supervisory

board, as applicable, is required to monitor issues relating to the preparation and review of accounting and financial information. […] The composition of the committee is determined by the board of directors or the supervisory board, as applicable. The committee must be composed entirely of non-executive members of the board of directors or the supervisory board. At least one member must have special skills in the area of finance or accounting and must be independent, as defined by precise criteria made public by the board of directors or the supervisory board".

AFEP/MEDEF recommendation concerning the composition of accounts/audit committees: "Independent directors should make up at least two-thirds of the members of the accounts committee and none of the members should be an executive corporate officer".

- *Scope*

Article L. 823-19 of the Commercial Code: "without prejudice to the powers of the board of directors or supervisory board, the committee is in particular responsible for monitoring:

- the financial reporting process;
- the effectiveness of internal control and risk management systems;
- the statutory audit of the company's annual and where applicable, consolidated accounts;
- auditor independence".

- *Possible exceptions*

Article L. 823-20 of the Commercial Code: "Entities with a board that performs the functions of the specialised committee referred to in Article L. 823-19 are exempt from the obligations of Article L. 823-19 […] provided that the board in question, which may be the board of directors or the supervisory board, is identified and its composition made public".

4.2.2. Findings:

By way of introduction, note that among the companies that did not have an audit committee (1 Segment A company and 20 small and midcaps), 80% did not say whether they were covered by Article L. 823-20 of the Commercial Code (i.e. whether the tasks of the audit committee had been assigned to the board) and 90% did not say whether they would take steps to ensure compliance.

- *Composition of the audit committee*

As in last year's report, the operating procedures of audit committees were assessed. A number of trends were apparent:

- The average number of directors on audit committees was 3.5, more or less the same as last year. The average was around 4 in Segment A (3.6 in 2007) and 2.8 among small and midcaps, unchanged from the previous year;

- The proportion of independent directors on audit committees was 60% among small and midcaps. A total 71% of chairmen of audit committees were independent directors, a higher rate than the previous year. In Segment A companies, the average ratio of independent directors fell slightly to 70% in 2008 compared with around 75% in 2007. In 81% of Segment A companies, chairmanship of the audit committee was entrusted to an independent director. Among small and midcaps, 55% of audit committees were chaired by an independent director;

- These statistics mask diverse practices that ought to be mentioned. For example, in situations where the chairman of the audit committee was not independent, he was nevertheless usually not the chairman of the board or the chief executive. And in the handful of instances where the chairman of the committee was also the chairman of the board, the company in question had a dual supervisory board/management board structure;

- *At least one independent director with special financial or accounting skills on the audit committee*

  - It is mandatory to have at least one "independent director with special financial or accounting skills" on the audit committee. Yet the proportion of companies that said they had at least one independent director with the accounting or financial skills referred to in the legislation remains low among Segment A companies (30%) and small and midcaps (17%) alike;

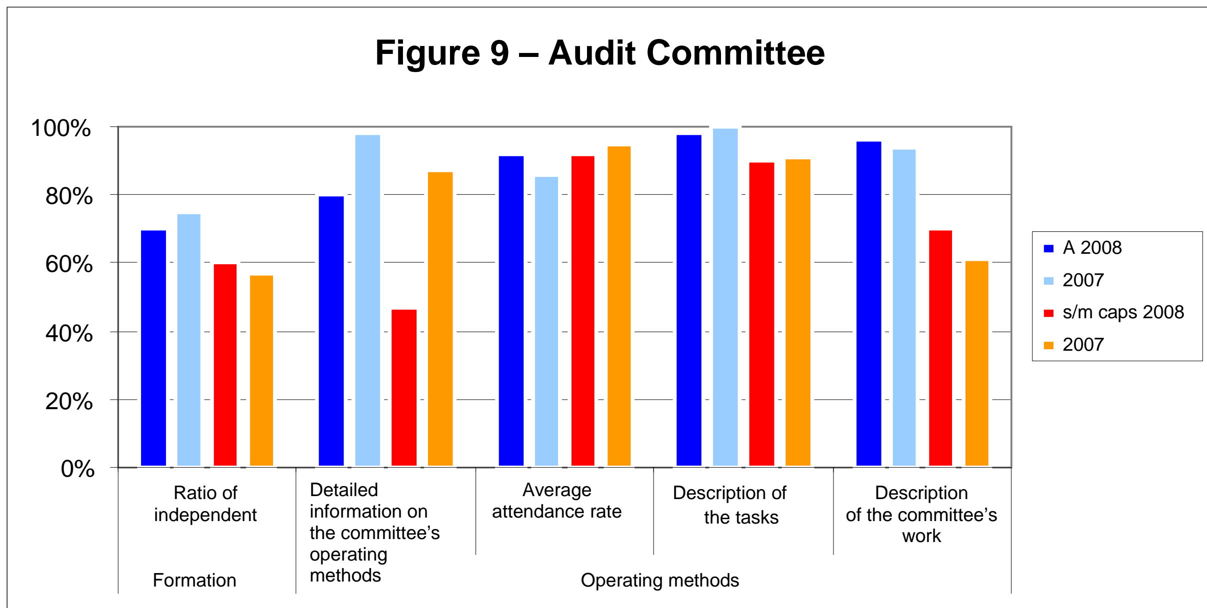
  - Of the 30% of Segment A companies that mentioned the presence of a director with "special financial or accounting skills", just 30% gave a definition for these skills. None of the 17% of small and midcaps provided information as to what this reference meant;

- *Operating methods of the audit committee*

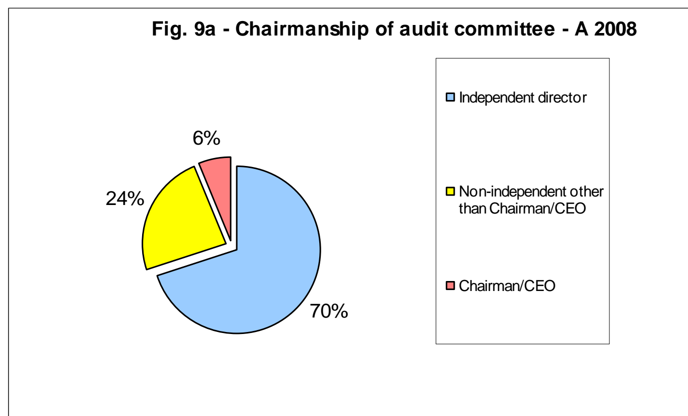
  - The question of audit committee operating methods was analysed by considering the number of companies that provided detailed information on this issue: 80% of Segment A companies and slightly more than 45% of small and midcaps supplied a detailed summary of the operating methods of their audit committee;

  - The number of meetings was around 5.3 a year for companies in the Segment A and 3 a year for small and midcaps. Attendance rates were up eight points in the Segment A to 92%, a level that was echoed among small and midcaps;

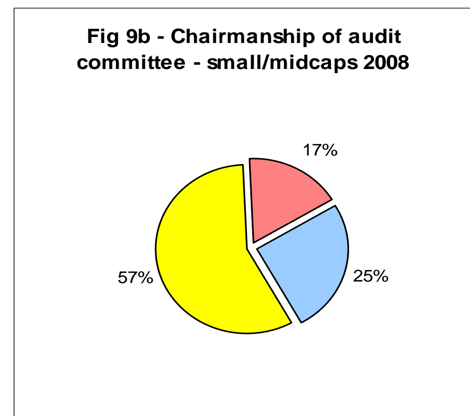
  - Similarly, practices in terms of describing the work of the audit committee showed an improvement on the previous year, and although small and midcaps continue to score lower than the Segment A in this area, they still recorded a marked increase (10-point rise).



Source: AMF



Source: AMF



Source: AMF

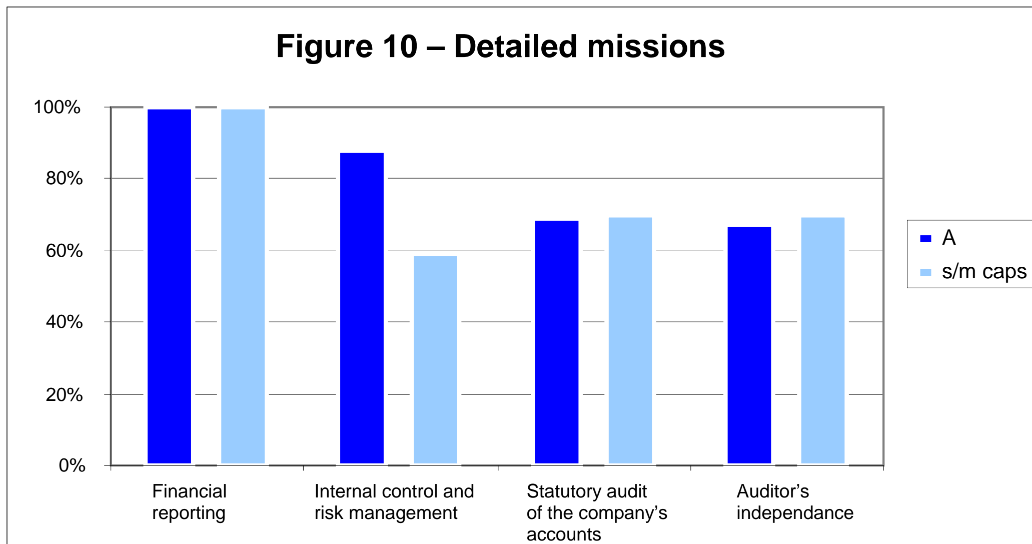
- *Tasks of the audit committee*

While monitoring the financial reporting process was always mentioned as one of the committee's tasks, references to other tasks were less consistent:

- monitoring the effectiveness of internal control and risk management systems: 88% of Segment A companies and 59% of small and midcaps mentioned this task;

- monitoring the statutory audit of the company's accounts: mentioned by around 70% of Segment A companies and small and midcaps;

- monitoring auditor independence: mentioned by 67% of companies in the Segment A and 70% of small and midcaps.



Source: AMF

The Commercial Code now makes it mandatory to establish a specialised committee whose key tasks include monitoring issues relating to the preparation and review of accounting and financial information.

To promote transparency, the AMF asks companies to say explicitly which body is in charge of these duties. Furthermore, the AMF recommends that companies be more explicit when detailing the criteria defining the notion of financial or accounting skills.

In addition, the AMF reiterates that company executives should not sit on (much less chair) the audit committee (Art L.823-19 of the Commercial Code).

4.3. Compensation committee

4.3.1. Reminder of legislation and recommendations

The AFEP/MEDEF recommendations are that the compensation committee should:

- "not include any executive directors, and should have a majority of independent directors";
- "help place the board of directors or the supervisory board under the best conditions to determine the whole of the compensation and benefits accruing to executive directors. All decisions are to be made by the board of directors or by the supervisory board".

4.3.2 Findings

Many Segment A and small and midcaps merged their compensation and appointments committees in 2008. While the average number of members on the committee remained the same (3 for small and midcaps, 3.6 for Segment A companies), the proportion of independent directors declined in both categories (Segment A: 65% in 2008 compared with 72% in 2007; small and midcaps: 43% in 2008 compared with 52% in 2007).

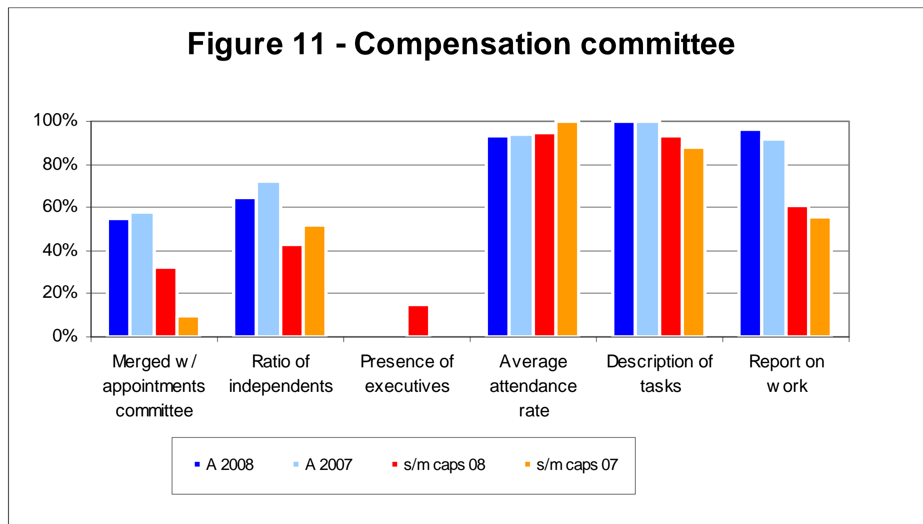
Similarly, the proportion of compensation committees chaired by an independent director also fell, to 53% in 2008 compared with 66% in the previous year (Segment A: 70% in 2008 compared with 77% in 2007; small and midcaps: 25% in 2008 compared with 32% in 2007).

This trend may be partly attributable to the mergers of compensation and appointments committees in 2008 and to the fact that the proportion of independent directors in appointments committees is generally lower than among compensation committees, to which the AFEP/MEDEF recommendation applies.

However, the make-up of compensation committees improved in other respects relative to the previous year: among Segment A companies with a compensation committee, the committee chair was also chairman of the board in 6% of cases.

At 21 small and midcaps, the compensation committee was not chaired by an independent director. Of these 21 companies, two included corporate officers on their compensation committees (one company from Segment C had its chairman/CEO chair the committee), which is not in line with the AFEP/MEDEF recommendation.

The number of meetings remained more or less stable (3.9 among Segment A companies and 2.4 among small and midcaps), but average attendance rates were down slightly across all categories. Small and midcaps provided more detail on the tasks of compensation committees and, on average, all companies showed an improvement in terms of reporting on the results of the committee's work.



Source: AMF

Compared with last year, the AMF noted that, on average, fewer compensation committees were chaired by independent directors. It urges companies to reverse this trend.

4.4. Appointments committee

4.4.1. Reminder of legislation and recommendations

AFEP-MEDEF recommendations on the appointments or nominations committee:

- It "may or may not be separate from the compensation committee";
- Composition is similar to that of the compensation committee, except that "the current board chairman shall be associated with the appointments or nominations committee's proceedings";
- Tasks include selection of new directors and succession planning for executive directors.

4.4.2. Findings

One company in the small and midcap category and 20 Segment A companies have set up appointments committees. The practices of these companies were unchanged relative to 2007, except as regards the proportion of independent directors, which fell by 10 points, from 66% to 56%.

Around one-half of the chairmen of appointments committees were independent directors (53% for compensation committees). Attendance rates were close to 95%. A similar proportion of companies provided detailed information about the tasks of the committee, while 90% reported on the results of the committee's work.

Companies are urged to pursue efforts made in past years to describe the way that committees function, as well as their tasks and results of their work. Moreover, companies are encouraged to prepare a report on the work of the committee that highlights interactions between these committees and the board.

On the question of composition, the AMF encourages companies to appoint independent directors to chair these committees and to increase the presence of independent directors in these committees generally.

Finally, the AMF encourages companies to make sure, as far as possible, that executive directors do not sit on, much less chair, these committees.

5. Evaluate the work of the board and its committees more effectively

5.1. Evaluation of the board

5.1.1. Reminder of legislation and recommendations

- **AFEP/MEDEF code**

For sound corporate governance, the board of directors should evaluate its ability to meet the expectations of the shareholders having entrusted authority to it to direct the corporation, by reviewing from time to time its membership, organisation and operation (which implies a corresponding review of the board's committees).

Accordingly, each board should think about the desirable balance in its membership and that of the committees created from among its members and consider from time to time the adequacy of its organisation and operation for the performance of its tasks

Preferably once a year, the board should dedicate one of the points on its agenda to a debate concerning its operation.
There should be a formal evaluation at least once every three years. It could be implemented, possibly under the leadership of an independent director, with help from an external consultant

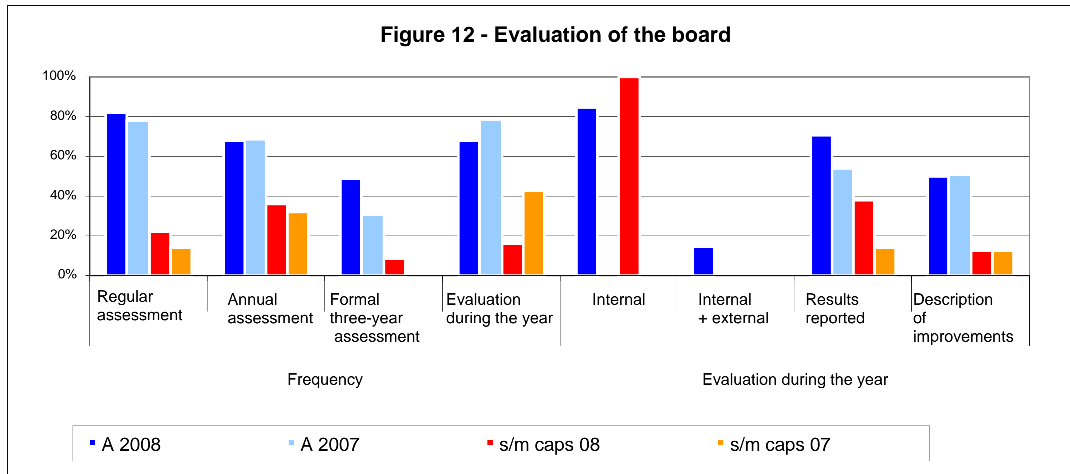
5.1.2. Findings:

Boards (and their specialised committees) are increasingly the subject of regular evaluations. Around 70% of Segment A companies and some 40% of small and midcaps are assessed annually[22]. At the same time, more and more companies (18-pt increase in the Segment A, 9-point increase among small and midcaps) have introduced formal three-year evaluations.

In 2008 68% of companies in the Segment A and 16% of small and midcaps carried out evaluations (42% on average for the sample). Although this is a lower proportion than in 2007, this may be because evaluations are carried out on a three year cycle, the first taking place in 2004 following the release of the AFEP/MEDEF recommendations. The vast majority of companies carried out these evaluations internally, although some companies from the Segment A (15%) used the services of an outside provider.

As regards reporting the results of the 2008 evaluations, 71% of companies in the Segment A and 38% of small and midcaps communicated these results, i.e. more than in the previous year. However, the number of companies describing potential post-evaluation improvements was unchanged at 43% on average, 50% in the Segment A and 13% among small and midcaps.

[22] An annual evaluation consists, generally speaking, of the inclusion on the board's agenda of a discussion on the organisation and operation of the board and its committees.



Source: AMF

Examples of good practice in terms of the results of board evaluations:

- "Directors wish to strengthen the financial function in the composition of the board, in view of the current balance, and to reiterate the training options available to directors."

- "Have the board do more in-depth work on market, liquidity and operational risk, and on informing its strategic thinking with the lessons that gradually emerge from the disruption of the crisis in terms of challenges and opportunities for the group."

As last year, the AMF reiterates that, once a year, companies should devote part of their agenda to a debate on the operation of the board and conduct a formal assessment at least once every three years. The AMF encourages companies to proceed, as far as possible, with an evaluation of the board's operation[23] and recommends that they provide details about how that evaluation was conducted, particularly if an outside provider was involved.

The AMF encourages companies to report on the results of this evaluation, as well as on follow-up, especially potential improvements considered by the company.

[23] Ricol Lasteyrie and Finca, two consulting firms, carried out a study of board assessment practices (CAC 40 and Next 20), which they released on 29 September 2009. The report concluded that the "traceability" of board positions and decisions could be improved by more systematic evaluation of the time taken to pass on documentation, the quality of reports and the availability of board members.

6. Other issues

6.1. Additional disclosures of information that could have a bearing on a takeover bid

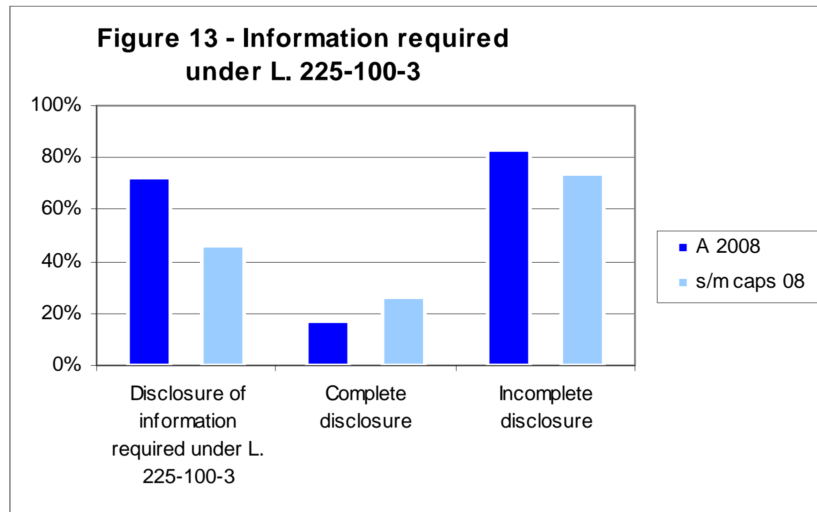
6.1.1. Reminder of legislation and recommendations

Article L. 225-100-3 of the Commercial Code, which is also mentioned in Article L. 225-37 of the same code, says that "in the case of companies whose securities are admitted to trading on a regulated market, the report referred to in Article L. 225-100 of the Commercial Code shall list and, where applicable, provide explanations for the following information if it could have a bearing on a takeover bid:

- the capital structure of the company;
- statutory restrictions on the exercise of voting rights or share transfers or clauses of agreements brought to the attention of the company pursuant to Article L. 233-11;
- direct or indirect interests in the capital of the company that are known to the company in accordance with Articles L. 233-7 and L. 233-12;
- the list of holders of any securities having special control rights, along with a description of those rights;
- the system of control of any employee share scheme where the control rights are not exercised directly by the employees;
- agreements between shareholders that are known to the company and may result in restrictions on share transfers and the exercise of voting rights;
- rules governing the appointment and replacement of members of the board of directors or the management board and amendments to the company's articles of association;
- the powers of the board of directors or the management board, in particular the power to issue or buy back shares;
- agreements signed by the company that alter or terminate upon a change of control of the company, unless such disclosure, other than where legally required, would be seriously prejudicial to the company;
- agreements providing for compensation for members of the board of directors or management board or employees if they resign or are made redundant without valid reason or if their employment ceases because of a takeover bid."

6.1.2. Findings

More than 70% of Segment A companies published the information requested under Article L. 225-100-3. By contrast, more than one-half of small and midcaps did not provide these disclosures. When such information was published, it was often incomplete and cross-references to other parts of the registration document were not always provided. Furthermore, when the information required under the abovementioned article was not provided, companies did not specify whether this was because none of the disclosures was applicable.



Source: AMF

To improve clarity, it is recommended that companies group the disclosures required under L. 225-100-3 in the same paragraph and indicate if items are not applicable.

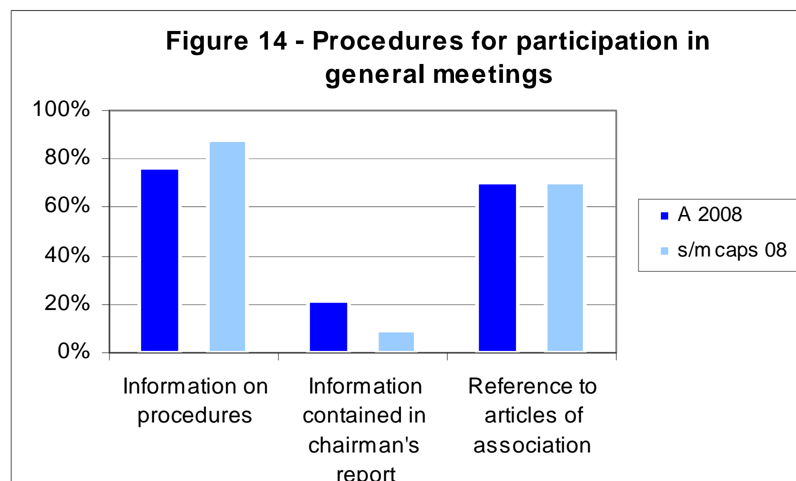
6.2. Procedures for taking part in annual general meetings

6.2.1. Reminder of legislation and recommendations

Art. L.225-37 of the Commercial Code: "the report [of the chairman on corporate governance and internal control] provided for in this article shall also specify the particular procedures governing shareholder participation in general meetings or shall refer to the sections of the articles of association that set out these procedures".

6.2.2. Findings

Just under 80% of companies in the Segment A and around 90% of small and midcaps described the procedures governing shareholder participation in general meetings. When this information was provided, it was in the vast majority of cases done so through a reference in the chairman's report to the relevant sections of the articles of association.



Source: AMF

The chairman's report should preferably include information about, or at least a reference to, the particular procedures governing shareholder participation in general meetings.
As regards electronic voting by shareholders, the AMF reiterates that legal certainty is prerequisite before this voting technique can become more widespread.

6.3. Capital increases without pre-emptive rights or a public offering

- Findings

Many issuers put one or more resolutions to their general meeting seeking to use the new arrangements for capital increases without pre-emptive rights or a public offering.

The AMF repeats its recommendation of 6 July 2009 on the submission of resolutions to general meetings concerning the delegation of authority (Article L. 225-136 of the Commercial Code).

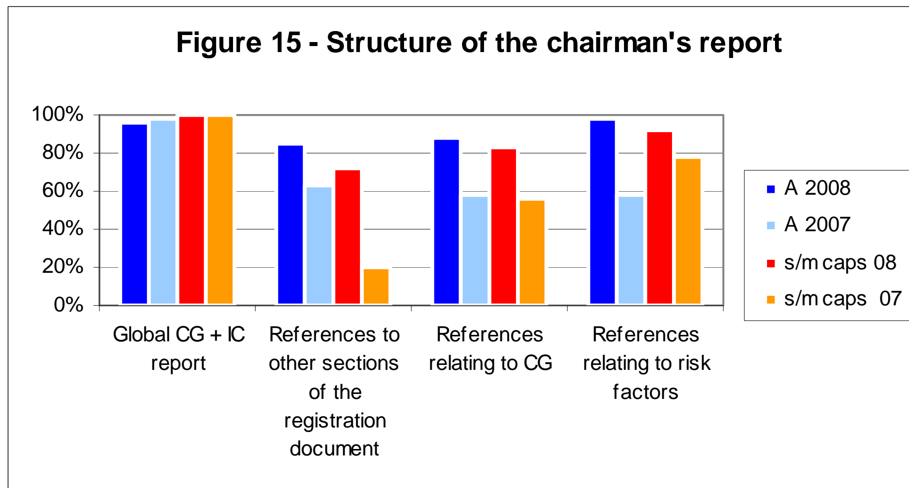
To ensure that voting on such authorisations is consistent with the principles of transparency and good governance, on the one hand, and shareholders' rights, on the other hand, the AMF recommends that issuers vote on individual resolutions for these types of issues. In particular, combined votes should not be held on capital increases that target different groups (public or qualified investors only) and are subject to different regimes (legal maximum of 20% applicable to issues without a public offering). In addition to the legal risk entailed in combining decisions relating to different regimes within the same resolution, the AMF considers that to satisfy governance rules and uphold shareholders' rights, issues subject to different regimes should be voted on separately at the general meeting.

6.4. Structuring the chairman's report

In virtually all cases, the chairman's report covers two areas: corporate governance and internal control. However, reports often include references to other sections of the registration document.

This trend seems to have strengthened relative to 2007. This may reflect the increased number of required disclosures in the report and the cross-referencing of these disclosures with other data in the registration document.

References to other sections of the registration document are chiefly concerned with the operation of the board (composition, rules of procedure and so on) and risk factors. More companies in the Segment A put in references compared with small and midcaps.



Source: AMF

The AMF reiterates the need for clarity in the presentation of the report on corporate governance and internal control.

It recommends that, when the contents of the report are spread out over several sections of the registration document, the report should refer readers to these sections.

Companies that publish their registration document in the form of an annual report should supplement the cross-reference table with such references.

7. Analysis of the results of the AFEP/MEDEF report of 18 November 2009

On 18 November 2009, AFEP and MEDEF published a "Report on the implementation of the corporate governance code for listed companies". The report, which looks at implementation by companies in the SBF 120 and CAC 40 indices during 2008, examines application by companies of the AFEP/MEDEF recommendations on corporate governance (role of the board of directors or supervisory board and committees) and executive pay.

The following observations may be made concerning the report's findings:

- Sample

The AFEP/MEDEF analysis considers 105 companies in the SBF 120 index, including 35 companies from the CAC 40. The AMF's analysis in this report looks at a sample of 100 companies made up of 50 companies from the Eurolist Segment A and 50 small and midcap companies (20 companies from Segment B and 30 from Segment C [24]). The results of the AFEP/MEDEF report should therefore be compared with those of the A companies in the AMF's sample, bearing in mind, however, that the AMF's sample of Segment A companies includes 15 non-CAC 40 companies.

- Findings

In general, the AFEP/MEDEF report found that "implementation by companies of corporate governance recommendations continues to improve". It also included the following additional assessments:

- proportion of independent directors: the report distinguishes between controlled and non-controlled companies to assess companies' compliance with the AFEP/MEDEF recommendation on the number of independent directors on boards, which is higher in companies with a dispersed ownership structure;
- compensation of board members: the report indicates that the results are consistent with the AFEP/MEDEF recommendation;
- term of office: the report finds that the terms of office of CAC 40 directors are now consistent with the AFEP/MEDEF recommendation (less than four years).

However, the AMF and AFEP/MEDEF findings differ on the following points:

- content of rules of procedure: the AFEP/MEDEF report says that "there are no obligations in terms of the level of information to provide to shareholders and that this level is to be determined by the board of directors". The AMF is proposing holding discussions on transparency in this area (Cf. discussion area no. 4 of this report);

- greater compliance by companies in terms of including the phrase "the principle that any material transaction outside the scope of the firm's stated strategy is subject to prior approval by the board of directors" (AFEP/MEDEF recommendation) in the rules of procedure: the AFEP/MEDEF report finds a sharp increase in the number of companies including this reference among SBF 120 and CAC 40 companies alike. The AMF believes that this reference should be linked to the question of the restrictions on the CEO's powers (Cf. recommendation in this report, page 28) and the limits on the board's authority, which should be specified in the rules of procedure;

- director independence: the AFEP/MEDEF report's finding is general. The AMF's report (see II.3) makes a more nuanced analysis of the way in which companies are applying the AFEP/MEDEF recommendations;

[24] Cf. Annex 2 of this report.

- reference to the financial and accounting skills of independent directors: the AFEP/MEDEF report says that merely publishing the CVs of directors is enough to show their financial and accounting skills. The AMF would like to hold a conversation on this issue (see discussion area no. 2);

- evaluating the work of the board: the AFEP/MEDEF report's finding is extremely positive. Because it combines the publication of results and the follow-up on board assessments, the findings are sharply different from those given in this report by the AMF, which urges companies to report on the results of evaluations and on their follow-up (see page 47).

III – INTERNAL CONTROL

1. Clarify reference to a code

1.1. Reminder of legislation and recommendations

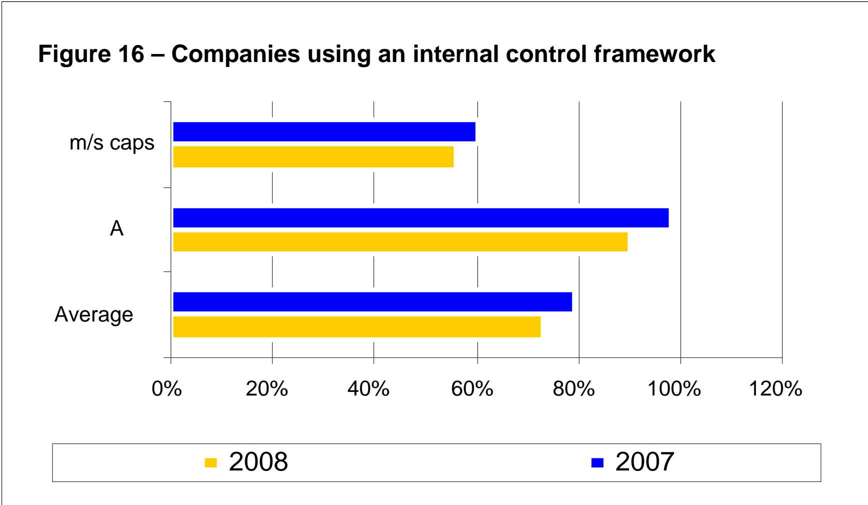
In January 2007 the AMF recommended that all companies making public offerings in France should use the internal control reference framework supplemented by the application guide for financial and accounting reporting for financial years beginning on or after 1 January 2007.

On 9 January 2008 the AMF recommended that companies not listed on Segment A Euronext Paris should use the simplified application guide that it had prepared.

1.2. Findings

- Use of AMF, COSO or other frameworks

Taking all three segments together, 73% of companies in the sample use a reference framework for internal control. However, there is a disparity between the two sub-samples: the figures are 90% for the companies in Segment A, versus 56% for small and midcaps.

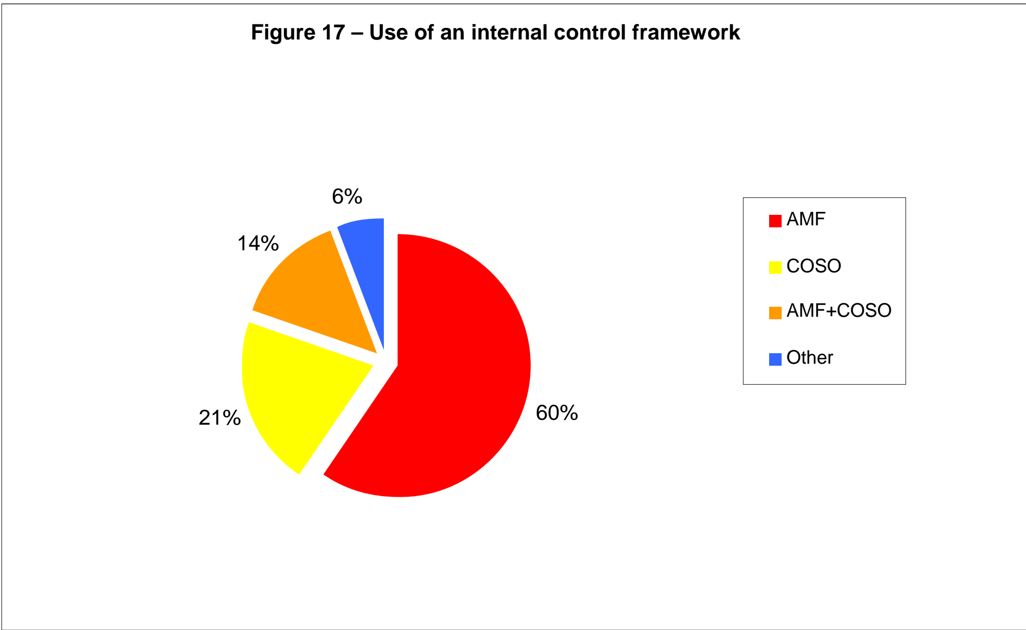


Source: AMF

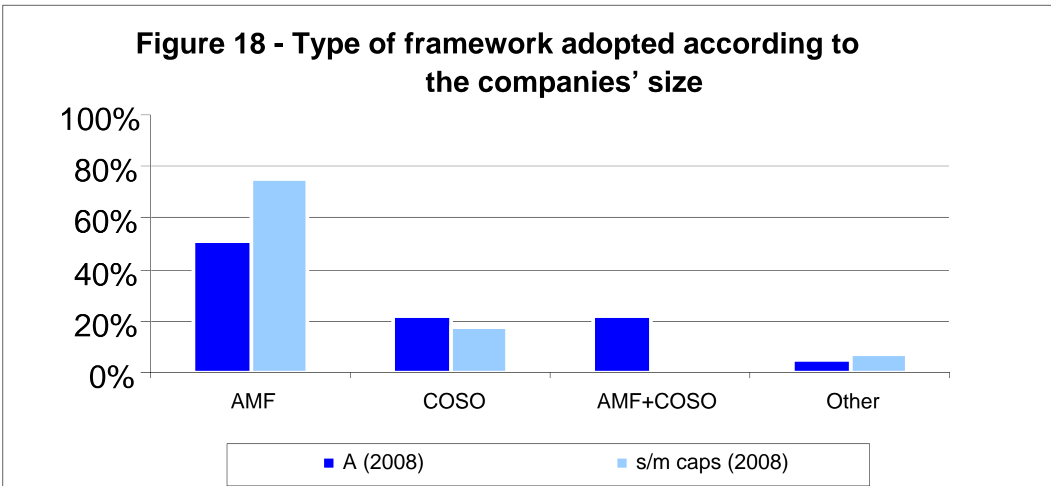
While 73% of all companies in the sample say they use a reference framework, at least four different methods of subscribing to such a framework were identified:

- 60% of all companies (compared to 57% for the 2007 reporting period) subscribe to the AMF framework alone (51% of Segment A and 75% of small and midcaps);
- 21% of all companies subscribe to the COSO framework[25] alone (22% of Segment A and 18% of small and midcaps);
- 14% of all companies subscribe to both the AMF and COSO frameworks (22% of Segment A and 0% of small and midcaps);
- 5% of all companies subscribe to other frameworks (5% of Segment A and 7% of small and midcaps);

The practice of using both the AMF guide and the COSO framework is relatively common in Segment A, but nonexistent among small and midcaps. The companies that stated that they use an 'other' code are either banks or asset management companies subject to supervision by the Commission Bancaire or to the Sarbanes-Oxley Act.



Source: AMF



Source: AMF

[25] The reference framework for internal control developed by the Committee Of Sponsoring Organizations of the Treadway Commission in 1992 and extended in 2002 (COSO II).

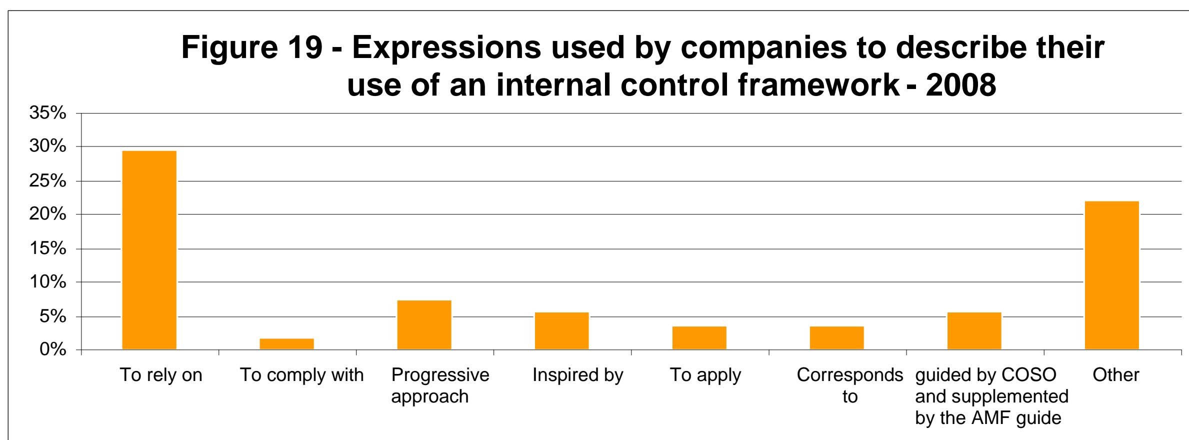
- Terminology used to establish a link with a framework:

The expressions used by companies to describe their use of an internal control framework can be a source of uncertainty. Companies often use imprecise terms that do not clearly indicate the level of adherence to the chosen standard. The most common expression, used by nearly 30% of the companies in the sample, is the verb "to rely on".

Only three other expressions were used by more than 5% of the companies in the sample.

- "is guided by the framework" (COSO, AMF or other);
- "is guided by COSO and supplemented by the AMF guide";
- "adopts a progressive approach to the application of the framework in question" (i.e. the company is bringing itself into compliance).

Other practices (which together accounted for 12% of companies in the sample), include expressions such as “developed from”, “used the AMF definition”, “followed the example of the AMF definition”, “followed from the AMF framework”, “fits within the AMF framework”, and so forth.



Source: AMF

Companies are encouraged to specify in the chairman’s report whether they have relied on the AMF reference framework or the guide for implementing the reference framework when drafting the report. Where the reference framework or guide is applied only partially, companies should clearly identify the areas or key internal control processes where they were applied, taking into account the nature of their business, their size and their form of organisation.

The same principles of transparency should be applied to the use of any other framework that the company chooses or is required to apply at the international level and that should therefore be disclosed.

The AMF encourages companies that do not currently use a framework to be more explicit on this point.

2. Use the chairman's report on internal control to describe risk management systems in more operational terms

2.1. Reminder of legislation and recommendations

Article L.225-37 of the Commercial Code sets the following requirements:

- the chairman of the board of director reports on the composition, preparation and organisation of the work of the board, as well as on internal control and risk management procedures established by the company, particularly those procedures relating to drawing up and processing accounting and financial information;

- the chairman's report should indicate any restrictions that the board of directors places on the powers of the chief executive officer;

- it should also describe the mechanisms for the participation of shareholders in the annual meeting, or provide a reference to the sections of the articles of incorporation that set out these mechanisms;

- it should mention the publication of the information mentioned in Article L.225-100-3 of the Commercial Code.

2.2. Make better use of the AMF reference framework

As noted in January 2007, when it was published, the AMF internal framework is intended to help companies develop their internal control system and to make it an operational tool.

To improve understanding of internal control mechanisms, the AMF reference framework identifies five key points:

- the organisation of internal controls (who does what?);

- in-house dissemination of relevant information;

- risk identification;

- the control activities in response to those risks;

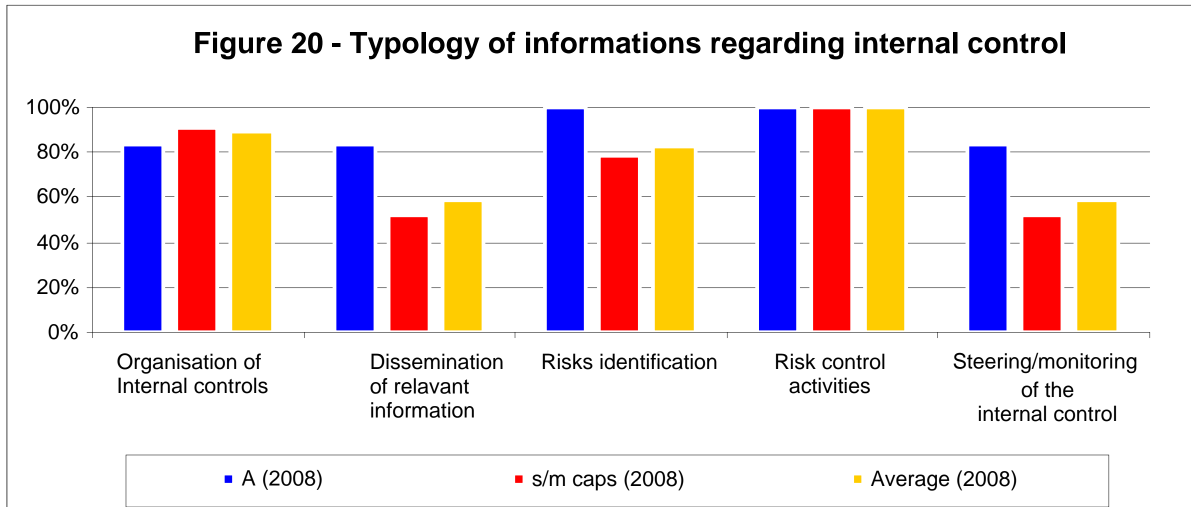
- the direction and supervision of the internal control system.

However, board chairmen have made little use of this nomenclature in developing and structuring their reports. Consequently, the documents analysed present information on internal controls in a wide variety of ways.

In general, Segment A companies and small and midcaps all describe how their internal controls are organised, identifying the various departments involved in the organisation and the mechanisms linking them (more than 80% of all the companies in the sample).

However, barely 50% of small and midcaps devoted a paragraph of the report to the dissemination of relevant information on internal controls and to the direction of internal control, while more than 80% of the companies in Segment A did so.

Nearly 80% of small and midcaps, and 100% of the companies in Segment A, discussed risk identification. The highest rate of adherence was for risk control activities (100% of companies provided detail on this topic). This figure is very likely due to the legal requirement to have this information examined by the statutory auditors.



Source: AMF

AMF notes that the presentation of internal control procedures does not always correspond to the framework chosen by the company. To improve the clarity and comparability of the information provided in the reports, the AMF recommends that companies make their descriptions conform to the structure of the framework they use. Establishing a reference framework should provide a form that is both practical for companies and understandable for shareholders.

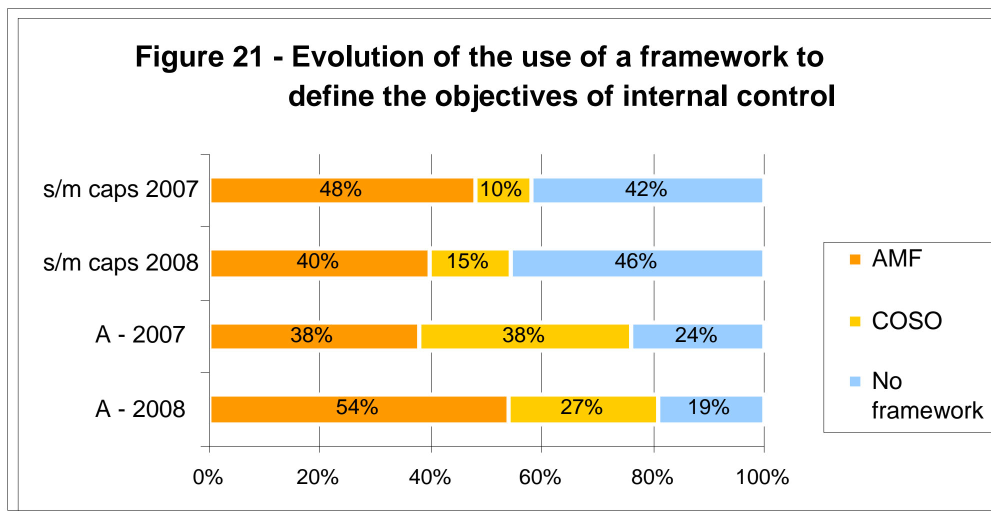
2.3. Establish a closer link between internal control objectives and the structure of the report

2.3.1. <u>Use of an internal control reference framework:</u>

Ninety-six percent of all companies discussed the objectives of internal control (the percentage is the same for Segment A companies and for small and midcaps). However, these objectives are not always the same as the objectives defined by a standard. Furthermore, when a company does adopt the objectives of a standard, it does not always adopt them in their entirety.

The standard most frequently used to define the objectives of internal control is the AMF reference framework. However, the trends are very different for small and midcaps versus Segment A companies. The proportion of small and midcaps using the definitions in the AMF reference framework declined by 8 percentage points compared to the 2007 reporting period. The proportion using the COSO framework increased by 5 percentage points, while the proportion not using any internal control reference framework increased by 4 percentage points.

In contrast, use of the AMF reference framework by companies in Segment A increased by 16 percentage points and now exceeds 50%, this increase coming largely at the expense of the COSO framework. The percentage of companies that do not use any internal control framework also declined.



Source: AMF

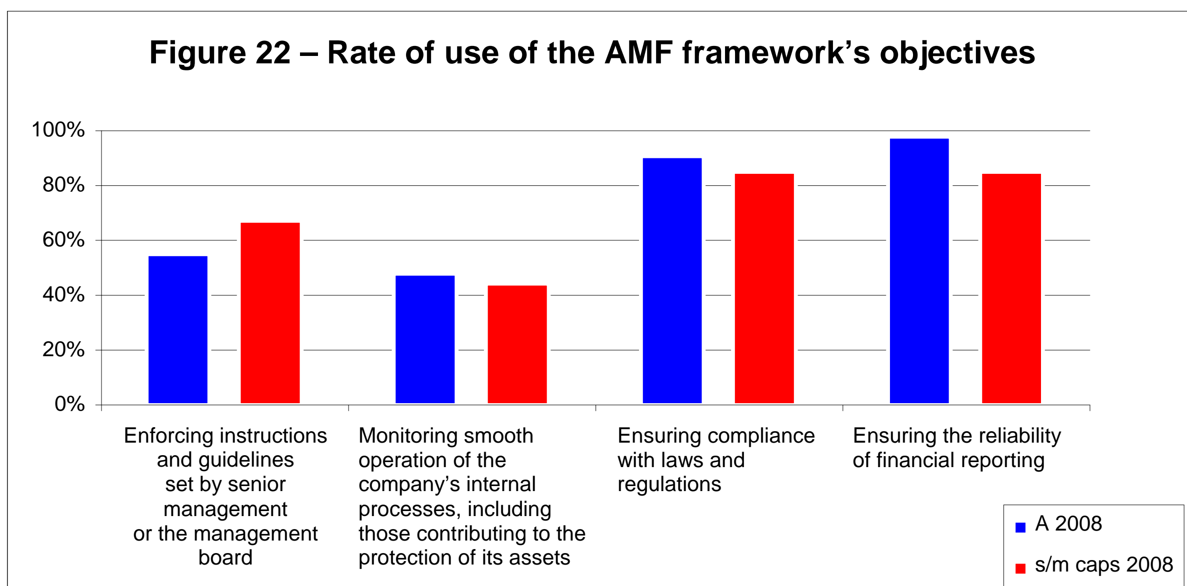
2.3.2. Objectives of internal control

Companies that have adopted the AMF framework to determine and describe their internal control objectives did not always mention all of the objectives in the AMF framework. Those objectives are:

- enforcing instructions and guidelines set by senior management or the management board;
- monitoring smooth operation of the company's internal processes, including those contributing to the protection of its assets;
- ensuring compliance with laws and regulations;
- ensuring the reliability of financial reporting.

An analysis of the sample reveals that:

- more than 80% of the companies in the sample, considering all segments together, have adopted at least the last two of these objectives: compliance with legal requirements and reliability of financial information. Both of these objectives relate to legal requirements;
- However, barely 40% mentioned the monitoring of internal processes as an objective of their internal controls;
- Finally, 55% of the companies in Segment A and 67% of the small and midcaps mentioned the application of the instructions and guidelines laid down by senior management.



Source: AMF

2.3.3. Limitations of internal controls

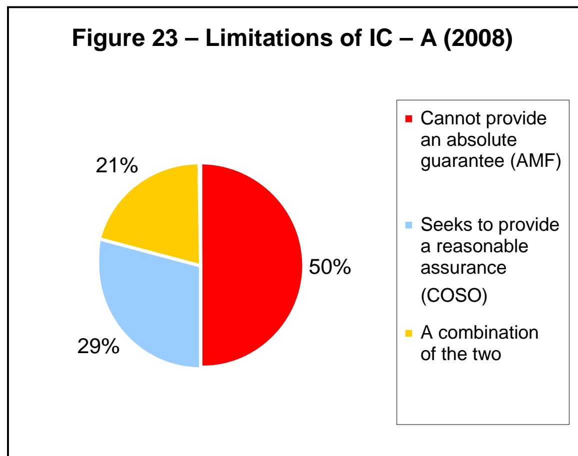
Companies also use standardised terminology to describe the limitations of internal controls. As was the case last year, more than 90% of the companies in the sample mentioned that internal controls have only limited effectiveness. This mention took three different forms:

- "cannot provide an absolute guarantee" (AMF framework);
- "seeks to provide a reasonable assurance" (COSO framework);
- a combination of the two.

While virtually all of the companies in the sample mentioned that internal controls cannot eliminate all the risks to which they are exposed, only 76% of the companies in Segment A and 68% of small and middle capitalisation companies used the exact terminology of the AMF or COSO frameworks. The rest expressed this idea in their own terms.

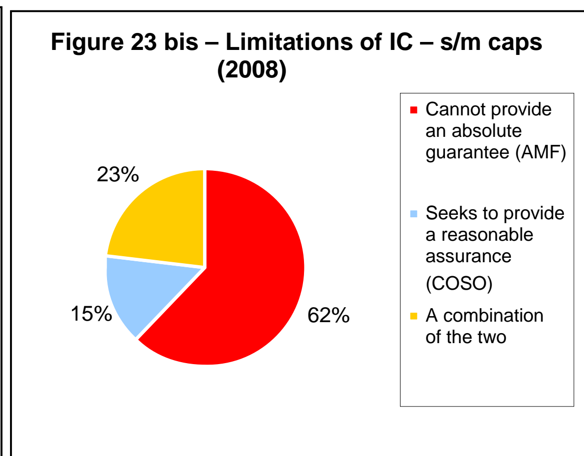
Of the three forms listed above, the expression "cannot provide an absolute guarantee", as stated in the AMF framework, was the form most frequently used in all three Segments, and particularly in small and midcaps.

Figure 23 – Limitations of IC – A (2008)



Source: AMF

Figure 23 bis – Limitations of IC – s/m caps (2008)



Source: AMF

The AMF recommends that companies strengthen the link between their stated objectives and the description of internal procedures in the chairman's report. The AMF also reminds companies that the scope of application of internal control is not limited to procedures that ensure the reliability of accounting and financial reporting.

2.4. Indicate more clearly the relationship between risks and risk management procedures

2.4.1. Reminder of legislation and recommendations

Companies should take note of the amendments to Articles L. 225-37 and L. 225-68 of the Commercial Code made by the DDAC Act of 3 July 2008, which provide that the chairman's report should cover the risk management procedures implemented by the company.

2.4.2. Findings

Internal control procedures are intended to provide the most effective possible management of the risks to which companies are exposed. Thus the procedures need to be adapted to the risks in question.

While the great majority of companies in the sample devoted at least one paragraph of the chairman's report to risk factors, only 66% of those in Segment A and 40% of small and midcaps say they have designed a full-scale risk mapping process. Only 30% of the companies (Segment A and small and midcaps combined) provided detail on the principal elements.

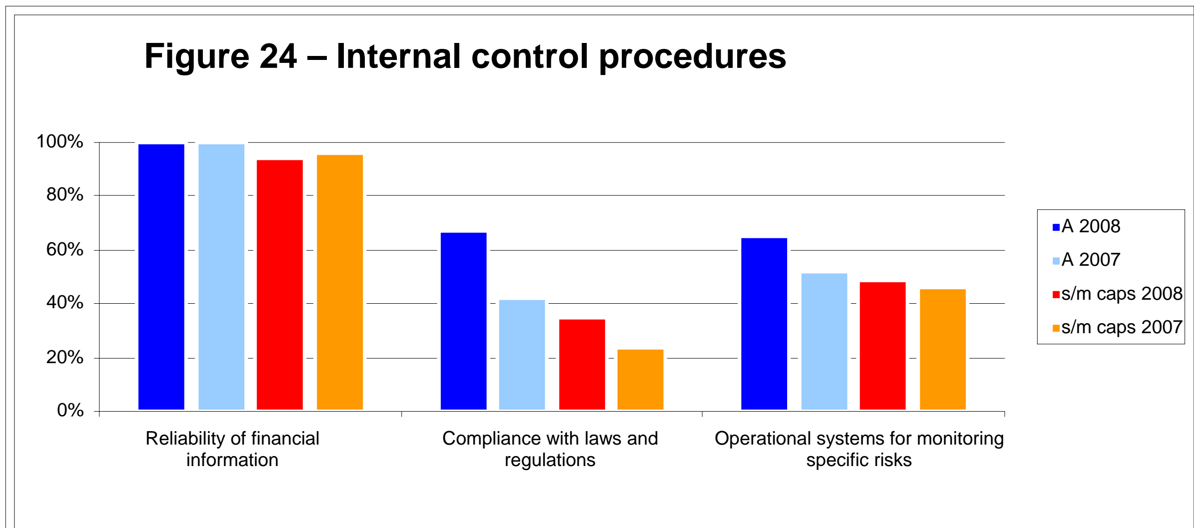
More than 70% of the companies in the sample mentioned the risks to which they are exposed (the percentage is the same for Segment A companies and for small and midcaps). However, practices differed when it comes to establishing a link between risk identification (often presented in the "risk factors" section of the registration document) and risk management procedures. Eighty percent of the companies in Segment A established this link (up from 78% in the previous year's report). The percentage of small and midcaps making the link was smaller (58%), but the increase over the previous year was greater (only 50% did so in 2007).

The detail provided by companies on their internal control procedures also varies widely.

With the exception of one company in the small and medium capitalisation sub-sample, the "monitoring of issues relating to drawing up and controlling accounting and financial reports", which is the responsibility of the audit committee or the accounts committee (Article L.823-19 of the Commercial Code), was detailed in all of the chairman's reports reviewed by the AMF.

The procedures relating to compliance with laws and regulations were less often described. Somewhat more than 60% of the companies in Segment A did so, but only 35% of small and midcaps. However, these practices are improving: the percentage of Segment A companies increased by 15 percentage points over the previous year, while the percentage of small and midcaps remained stable).

Companies provided less detail about their operational systems for monitoring specific risks. Approximately 65% of Segment A companies and 50% of small and midcaps devoted a paragraph to this subject.



Source: AMF

Internal control procedures are more effective when supported by the identification of the main risks, which only the company itself can do. The AMF therefore renews its recommendation to establish a link between risks – particularly those described in the 'risk factors' section of the registration document – and the risk management procedures established by the company.

Providing this link should make it easier to understand how the company perceives, formalises, and ultimately attempts to manage its risks. To that end, companies are encouraged to develop a risk mapping process.

3. Clarify the roles of the parties involved in internal control

Ninety percent of the companies in Segment A and 82% of small and midcaps discussed the personnel assigned to internal control and to the departments involved in the internal control system. However, relatively few of these companies provided detail on the personnel: their numbers, functions, their position in the hierarchy, and their interactions (if any) with specialised committees such as the audit committee. Eighty percent of the companies in Segment A and 85% of small and midcaps provided information on this point.

Finally, only 7% of Segment A companies and 2% of small and midcaps present a clear organisation chart identifying functions and reporting lines.

The AMF encourages companies to provide a description of the key personnel in the internal control system and all the parties involved in risk management. This description should indicate their reporting method, their duties and the environment in which these are carried out.

4. Improve the assessment of internal control procedures

4.1. Assessment of internal controls

4.1.1. Reminder of legislation and recommendations

In its Internal Control Reference Framework, the AMF recommends ongoing monitoring of the internal control system together with a regular review of how it operates, in order to promote continuous improvement.

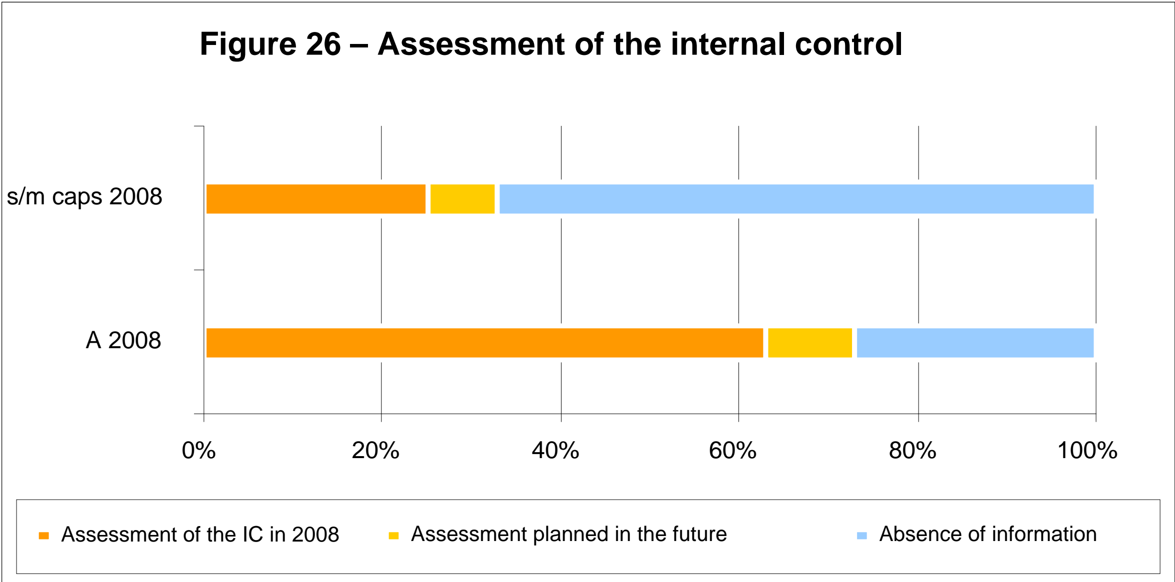
In its 2008 Report on Corporate Governance and Internal Control, the AMF also recommended that companies describe their work to improve their internal control processes, in particular through self-assessment questionnaires.

4.1.2. Findings

Ninety-eight percent of the companies in Segment A and 56% of small and midcaps (compared to 70% last year), say they have established an "ongoing internal control improvement programme", but only one-quarter of the companies (Segment A and small and midcaps combined) did so in precise terms.

Of the companies in the sample that say they had established an ongoing internal control improvement programme, 66% provided detailed information on this subject. That percentage was the same for the two sub-samples.

Sixty-three percent of Segment A companies and 25% of small and midcaps conducted an assessment of all or part of their internal control procedures (the percentages were equivalent in the previous year). Of the 37% of companies in Segment A and the 75% of small and midcaps that did not conduct an assessment of their internal controls in 2008, 28% of the companies in Segment A and 19% of small and midcaps stated that they planned to do so within the next few years.



Source: AMF

The findings for the 63% of Segment A companies and the 25% of small and midcaps that did conduct assessments were as follows:

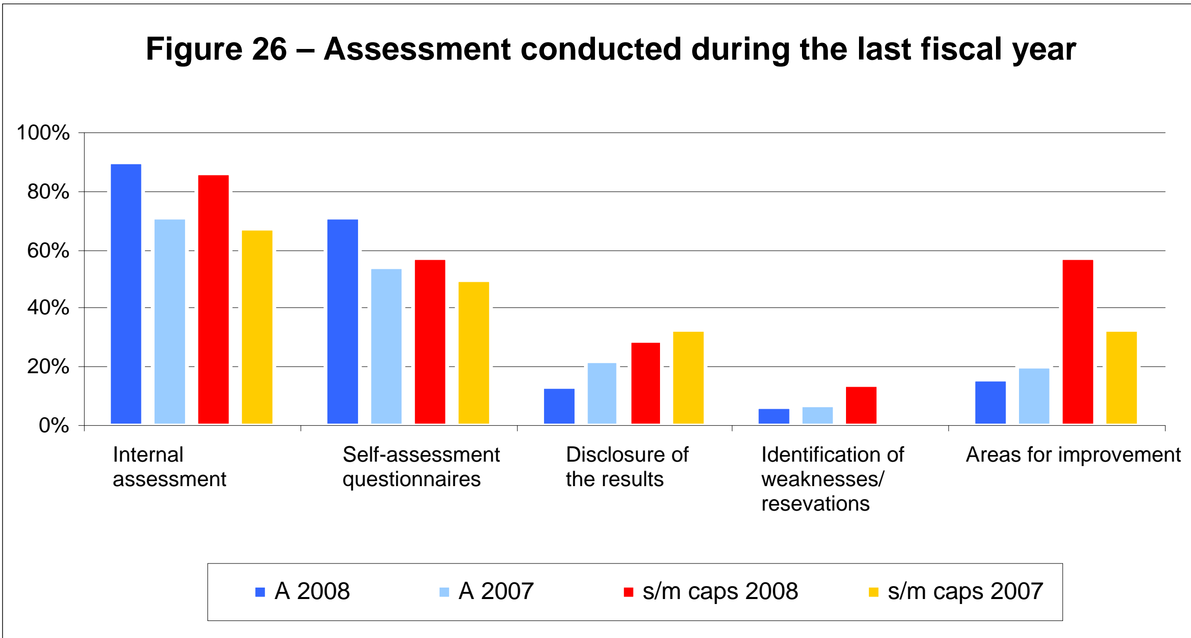
Some of the findings were encouraging:

- Ninety percent of the evaluations conducted by companies in Segment A were internal, compared to 86% for small and midcaps. These percentages were much higher than the previous year (70% of the assessments were internal in 2007). Three companies conducted an assessment that combined internal and external elements, and only a single company in Segment A had its assessment carried out entirely by an external agent;
- Of the companies in Segment A that conducted an assessment during the year, 71% used self-assessment questionnaires. The corresponding percentage for small and midcaps was 57%.

Other findings were more mixed:

- Only 13% percent of the companies in Segment A and 29% of small and midcaps disclosed the results of their assessment;
- Only 6% percent of the companies in Segment A and 14% of small and midcaps stated that they identified weaknesses or expressed reservations based on the assessment;
- Only 16% percent of the companies in Segment A devoted a paragraph to areas for improvement in the context of the ongoing internal control improvement programme. For small and midcaps, this figure was 57%.

Figure 26 – Assessment conducted during the last fiscal year



Source: AMF.

The AMF renews its recommendation concerning companies' description of work to improve their internal control processes, in particular through self-assessment questionnaires.

In addition, companies are encouraged to provide details on the results of their assessments, and to disclose any internal control failures or serious shortcomings revealed by the assessment or at any other time, particularly when preparing the chairman's report.

The AMF also encourages companies to detail the areas for improvement identified in their ongoing internal control improvement programme.

The AMF stresses the need to enhance internal control improvement programmes by linking them to the company's strategy and objectives. Companies are encouraged in this way to modify their practices, moving towards a broader form of overall risk management as an integral part of all of the company's activities.

4.2. Reports of the statutory auditors

4.2.1. Reminder of legislation and recommendations

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

Article L.225-37 mentions the information that can have an impact in the event of a public offering.

4.2.2. Findings

Ninety-nine percent of the companies in the sample included the report of the statutory auditor in their registration document, usually as an appendix to the chairman's report. Of those 99%, only 3% of the reports are evaluative, and these companies are all subject to the Sarbanes-Oxley Act.

None of the statutory auditors' reports mentioned reservations, observations, additional due diligence, major deficiencies, deficiencies identified in the course of preparing the chairman's report for 2008, or any disclosure on this subject prior to publication of the report.

Ninety-four percent of the companies in the sample provided the new information required by Article L.225-37 of the Commercial Code. Of the six companies that do not yet comply with this requirement, three are in Segment A and three are small and midcaps.

DISCUSSION AREAS

Discussion area no. 1: Given the report's observation that there are many different interpretations of what is meant by the independence and financial/accounting expertise of directors (concepts that are referred to in the regulations), discussions could be held on:

- clarifying the concepts of independence and financial and accounting expertise;
- independent directors, and how to square their position with compensation procedures and their role on boards;
- the right balance between independence and competence through the appointment of directors with an appropriate professional activity.

Discussion area no. 2: Begin discussions about boardroom diversity. Aside from the need for boardmembers to have specific individual qualities, such as independence, competence and experience, greater diversity, with more women, foreign directors, and so on, might well help to enhance the quality of work done by boards. This raises the question of the representation of women on corporate boards, which stood at 10.6% at end-2008. It has been established that this issue is closely linked to that of combining multiple corporate offices.

Discussion area no. 3: Hold discussions about the stability of corporate governance arrangements and about explanations provided in this regard, particularly in situations where a company returns to a governance structure it recently abandoned.

Discussion area no. 4: To ensure that boards and specialised committees function in an orderly fashion and with greater transparency, consideration might be given to publishing companies' bylaws in a more obvious way, for example on their website, and to consider a standard format, which might include:

- the composition and operating procedures of boards;
- the distribution of work between senior management and the decision-making body;
- the composition, operating procedures and tasks of specialised committees;
- the directors' charter and the code of conduct, if these documents exist.

The AMF suggests that industry groups take the above guidelines into account when discussing these issues.

Discussion areas relating to internal control and risk management will be covered by the working group recently set up by the AMF on audit committees and internal control[26]. The group has been asked to prepare a guide to audit committees and to suggest amendments to the reference framework for internal control and risk management introduced by the AMF in 2007.

The group began work in October 2009 with a view to:

- setting out practical guidance on the remit of the audit committee, in compliance with the Executive Order, by explaining the terminology used in the Order;
- anticipating the changes to be made in order to accommodate small and medium capitalisation stocks ("small and midcaps");
- re-examining the issue of whether the chairman's report should have an evaluative focus.

The group's findings will be put out to consultation and are due to be made public in summer 2010.

The questions raised by the working also relate to the following issues:

- the linkage between accounting standards, management of the company's business (i.e. methods for recognising income) and internal control and risk monitoring mechanisms;
- the requirement for companies to give a more detailed account of risk management procedures in the chairman's report.

[26] Working group chaired by Jean-François Lepetit and Olivier Poupart-Lafarge, members of the AMF Board. Members include representatives of listed companies, members of industry groups and experts in the areas concerned.

GENERAL CONCLUSION

This report is the first to be based on disclosures made by companies pursuant to the new Community framework following transposition into French law of Directives 2006/43/EC and 2006/46/EC.

Regarding corporate governance, our analysis of the sample has yielded rather encouraging results that reflect a continuous improvement in French companies' practices. The study also points to areas for improvement, such as providing a clearer definition of independent directors and organising regular board assessments.

On the issue of internal control, evidence confirms that a majority of companies (60% compared with 57% in 2007) have adopted the AMF reference framework as a management tool, three years after it was first published. However, there is still scope for improvement, for example in describing risk management procedures.

For next year the AMF calls on companies to heed the recommendations in this report and refer to the proceedings of the audit committee working group set up by the Board in October 2009. The group's findings are due to be published in summer 2010.

Annex 1

Summary of meetings with companies in the sample

Our meetings with some of the sample companies gave us the opportunity to dialogue with the personnel involved in internal control, including chief financial officers and heads of internal control or internal audit in companies listed Segments A, B and C.

The purpose of these meetings was to determine opinions and practices in terms of internal control and adoption of industry standards in this area.

Broadly, companies responded favourably to the question about using the AMF reference framework when drafting the chairman's report. In such cases the framework is a multi-purpose communication resource. Internally it can be used as an operational tool at all levels, while externally it allows for transparent reporting based on a recognised structure.

Furthermore, it seems to be used increasingly as a basis of assessment and a tool for responding to investment analysts, particularly on issues of sustainable development and socially responsible investing. In sum, the companies surveyed for this report said the reference framework allowed them to disseminate detailed internal control policies and ensure they are understood, both internally and externally.

Several companies said they wanted the AMF to continue publishing its annual report on corporate governance and internal control in the first half of December at the latest so they can apply its recommendations when drawing up their report for the current year.

Annex 2 -

Sample companies

"Euronext A" sample

CAC 40

1 Accor
2 Air France -KLM
3 Air Liquide
4 Alcatel-Lucent
5 Alstom
6 AXA
7 BNP Paribas
8 Bouygues
9 CAP Gemini
10 Carrefour
11 Crédit Agricole
12 Danone
13 EDF
14 Essilor Intl.
15 France Telecom
16 GDF Suez
17 L'Oréal
18 Lafarge
19 Lagardère S.C.A.
20 LVMH
21 Michelin
22 Pernod Ricard
23 Peugeot
24 PPR
25 Renault
26 Saint Gobain
27 Sanofi-Aventis
28 Schneider Electric
29 Company Générale
30 Suez Environnement
31 Total
32 Unibail-Rodamco
33 Vallourec
34 Véolia Environnement
35 Vinci (ex SGE)
36 Vivendi

EURONEXT A ex CAC 40

1 Areva
2 Arkema
3 BIC
4 Ciments Français
5 Eiffage
6 Eurazeo
7 Iliad
8 Klépierre
9 Pages Jaunes
10 Publicis Group
11 SEB
12 Seche Environnement
13 Technip
14 TF1

“Small and midcaps" sample

EURONEXT B

1 Altamir Ambroise
2 Assystem
3 Boiron
4 Boursorama
5 Cofitem Cofimur
6 Gaumont
7 Groupe Go Sport
8 Guerbet
9 Hi-Media
10 IMS
11 Inter Parfums
12 Ipsos
13 Jaquet Métals
14 LISI
15 Mr Bricolage
16 Nicox SA
17 Sartorius Stedim Biotech
18 Sword Group
19 Thermador Groupe
20 Toupargel groupe

EURONEXT C

1 Acces Commerce
2 Aldeta
3 Aubay
4 Bioalliance Pharma
5 Bourse Direct
6 Compagnie Lebon
7 Diagnostic Médical
8 Finuchem
9 Foncière Inea
10 Guillemot Corporation
11 HF Company
12 High Co
13 Hologram Industries
14 IEC Multimedia
15 Itesoft
16 Jet Multimedia
17 Le Tanneur
18 Léon de Bruxelles
19 Naturex
20 Orapi
21 Paref
22 PCAS
23 Pharmagest Interactive
24 SIICinvest
25 Siparex Croissance
26 Sogéclair
27 Sperian Protection
28 Systran
29 Team Partners Group
30 Vivalis

AMF supplementary report on executive compensation in listed companies and implementation of the AFEP/MEDEF recommendations

The AMF published on 9 July 2009 its report on executive compensation in listed companies and implementation of AFEP/MEDEF Code. In concluding, it said the companies in the sample had made meaningful efforts in terms of transparency. However, it noted that there was still room for improvement and made several remarks aimed at upgrading the Code and implementing it more effectively.

Since publishing the report, the AMF has continued to monitor implementation of the AFEP/MEDEF Code and its recommendation on executive compensation[27] by reviewing registration documents and inspecting the information disclosed in connection with financial offerings or in order to comply with ongoing reporting requirements.

In light of new factors, the AMF released another report to supplement the observations and discussion areas published in July.

In particular the AMF examined the registration documents issued by companies listed on Segment A of Euronext Paris with a non-calendar financial year. The detailed findings of the examination are presented in an annex to this report.

Furthermore AFEP and MEDEF published a report on 18 November 2009 on implementation of the corporate governance code by companies in the SBF 120 and CAC 40 indices. The report's conclusions are broadly consistent with those in the AMF own report. However, the AFEP-MEDEF document calls for several comments, which are presented in the second part of this document.

1. Implementation of the AFEP/MEDEF Code by listed companies with a non-calendar financial year

The AMF examined the registration documents of eight companies listed on Segment A of Euronext Paris.

The results of the examination (see annex) confirm the observations made in the 9 July 2009 report. The AMF notes a marked improvement in disclosures on senior executives' pay. Companies have made significant efforts in terms of transparency in order to present precise, clear and personalised information on executive compensation in their registration document.

The fact that most of the companies used the tables given in the AFEP/MEDEF Code and in the AMF recommendation makes an overall reading easier.

However, some items need to be commented upon in greater detail:

- Two of the sample companies gave no information about the items of compensation paid to their non-executive chairman. The AMF points out that the compensation arrangements for non-executive chairmen must be published in the registration document. It also notes that such arrangements vary considerably from one company to another and therefore repeats its suggestion of initiating a debate on the methods of compensating non-executive chairmen, taking into account the diverse situations and variety of functions they carry out (discussion area 4 in the AMF report published on 9 July 2009). Similarly, regarding supplementary pension schemes, the AMF repeats the recommendation[28] made in its previous report, since several of the companies whose reports it examined do not provide all the information needed to assess compliance with the AFEP/MEDEF Code;

- The AMF recalls that the AFEP/MEDEF Code rules out termination payments to executive directors who are entitled to exercise their pension rights in the near future. The AMF noted that a senior executive at one of

[27] AMF recommendation on the information to be disclosed in registration documents on the compensation of executive directors – 22 December 2008

[28] AMF report on executive compensation in listed companies and implementation of the AFEP/MEDEF recommendations, published 9 July 2009 – "With regard to supplementary pension schemes, the AMF recommends that issuers should publish comprehensive information about individuals' potential rights, together with the methods for determining and calculating retirement benefits for each beneficiary (period and amount of reference salary, potential annual rights as a percentage of the reference compensation, aggregate potential annual rights at the end of the period, caps on potential rights, rules on seniority and presence in the company)."

the companies in the additional sample is entitled to severance pay if he leaves office even though he is likely to claim his pension rights.

- On the subject of stock options and bonus shares, the AMF notes that an AFEP/MEDEF recommendation issued in October 2008 states that internal and external performance requirements should apply to the exercise of all options granted to executives and the acquisition of all performance shares. The AMF notes that none of the sample companies say they apply a combination of internal and external criteria. This issue is addressed in greater detail in the second part of the report;

- Regarding the recommendation on not combining an employment contract with corporate office[29], the AMF recommends companies to say exactly what policy they apply with regard to persons already in office if they also have an employment contract. The AMF points out that, pursuant to the "comply or explain" principle, a company can decide to maintain the officer's employment contract provided its states the precise reasons for doing so. The AMF notes that, for the purposes of this report, several companies have decided to maintain the contracts of executive directors who have considerable experience as employees of their group. One company in particularly has abided by the disclosure rules and described the situation of its chief executive, which is not consistent with the AFEP/MEDEF Code according to a MEDEF blue-ribbon committee that questioned the company. The chief executive is paid by the issuer's holding company under the terms of an assistance agreement between the parent company and its affiliate. The AMF considers that the explanations proffered by the company to justify the situation are fairly general and do not therefore comply with the Code: this organisational structure safeguards the company's independence and allows it to "pursue a long-term strategy, ensure management continuity and secure its long-term future".

  By contrast, the AMF considers that an issuer complies with the code if it justifies its decision to maintain an executive's employment contract with regard to his or her length of service as an employee and to their personal situation;

- It should also be noted that one company says in its registration document, in accordance with discussion area 2 in the AMF's July 2009 report, that the executive "has undertaken, for his full term of office, not to hedge the stock options or performance shares awarded to him".

2. AMF comments on the AFEP/MEDEF report and corporate governance code

– Comments on the AFEP/MEDEF report

AFEP and MEDEF published on 18 November 2009 a report on implementation of their corporate governance code in an effort to assess compliance with its recommendations. The two organisations reviewed the 2008 annual reports and registration documents of almost all SBF 120 companies, apart from the section dealing with simultaneous holding of corporate office and an employment contract, which had been updated at the end of August 2009 when public data were made available.

The AFEP/MEDEF report bears out the findings of the AMF's July 2009 report. In particular the AFEP/MEDEF document confirms that issuers have made considerable efforts in terms of disclosure in order to present details of and changes in executive compensation in accordance with the code of best practice applied by major listed companies.

Often, however, the AFEP/MEDEF report looks at how companies implement the commitments involved in the various recommendations but fails to analyse the underlying criteria in full. Moreover, the two organisations consider that companies are in compliance with the code even if they do not provide details about the implementation of certain recommendations for which disclosure of "specific information" is non-mandatory, whereas the AMF considers that full disclosure is necessary.

[29] Note that this measure in the AFEP/MEDEF Code applies to the chairman, to the chief executive officer of companies having a board of directors, to the chairman of the management board, to the sole managing director of companies having a management board and a supervisory board, and to statutory managers of limited stock partnerships.

The AMF also notes that the AFEP/MEDEF report gives no assessment of the types of arguments put forward by issuers to explain why they do not apply some of the recommendations. This is significant because some of the explanations for non-compliance presented in the report are couched in very general terms. In these cases, the AMF considers that the lack of precise and detailed explanation renders the code meaningless. For example one company explains that it allows options or performance shares to be hedged so that its executives can manage their own assets. Another says it does not apply performance criteria when options are exercised, only when they are granted, and that those criteria are "in line with the company's interests".

Since the AFEP/MEDEF Code aims to enhance transparency and is based on the "comply or explain" principle, the AMF considers that companies are in breach of its terms if they fail to provide precise and specific explanations. On this point, AFEP and MEDEF ought to complain to the managers of a company, in accordance with the recommendations issued in October 2008[30], when, having analysed the information it has published, "they notice that [it] does not apply one of these recommendations and fails to provide an adequate explanation".

– Comments on the AFEP/MEDEF Code

Regarding the exercise of options and acquisition of performance shares, the AMF notes that the wording of the AFEP/MEDEF recommendation of 6 October 2008, stating that both internal and external performance requirements should apply, was amended in December 2008 when it was incorporated into the Corporate Governance Code. The code recommends the use of internal and/or external performance requirements, meaning that companies can usually dispense with comparing their performance with that of other companies or a benchmark sector.

The AMF has noticed from their registration documents that most companies apply one set of criteria only. It made a similar finding when checking a financial offering by an issuer that awards stock options subject solely to internal performance requirements. When explaining why it was applying internal performance requirements only, the issuer claimed it was complying with the AFEP/MEDEF Code.

The AMF suggests that the corporate governance code should be amended so that the exercise of all options granted to executives or the acquisition of all performance shares is subject to internal performance requirements and, where possible and relevant, with external requirements as well.

30 Recommendations concerning the compensation of executive directors of companies whose shares are admitted to trading on a regulated market – AFEP/MEDEF – October 2008 – page 7

3. Conclusion

Based on the observations made in its first report, published in July 2009, the supplemental remarks herein, and the observations in the AFEP/MEDEF report, the AMF concludes that, one year after the two industry groups published their recommendations; major listed companies (i.e. those in the SBF 120) have made genuine progress in terms of executive compensation disclosure.

It has noted, however, that some companies have not implemented all the recommendations. As a result, the AMF issued observations in July 2009 aimed at improving implementation of the AFEP/MEDEF recommendations. To move towards full disclosure, some aspects of the AFEP/MEDEF Code itself need to be clarified in order to dispel any ambiguities about the information to be provided. The AMF also suggests that the corporate governance code be amended so that the exercise of all options granted to executives or the acquisition of all performance shares is subject to internal performance requirements and, where possible and relevant, with external requirements as well.

Learning the lessons from this first year of application, companies should now be in a position to implement the AFEP/MEDEF Code comprehensively. Companies that do not apply some of the code's recommendations must make a special effort to explain their reasons. As it has done this year, the AMF will continue to monitor implementation of the AFEP/MEDEF Code with regard to executive compensation, paying particular attention to companies listed in Segment A of Euronext Paris.

- **ANNEX I**

Sample companies:

Air France KLM
Alstom
Eutelsat Communications
Neopost
Pernod Ricard
Remy Cointreau
Sodexo
Ubisoft Entertainment

▪ ANNEX II: APPLICATION BY LISTED COMPANIES OF THE AFEP/MEDEF CODE

The observations and comments below are based on information in the registration documents of eight companies listed on Segment A of Euronext Paris (see list in Annex I).

Seven of the eight state that they comply fully with the code. In general they say in their statement that the code's recommendations are consistent with their own corporate governance policies. However one company expressed reservations about the recommendation on not combining corporate office with an employment contract.

The methodology used by the AMF for this annex is the same as that employed for its July 2009 report. In view of the size of the sample, however, no statistics have been compiled about the amounts paid in compensation or the membership of the companies' administrative or supervisory bodies.

1. TERMINATION OF THE EMPLOYMENT CONTRACT IN THE EVENT OF APPOINTMENT TO A CORPORATE OFFICE[31]

- 3 companies say they do not combine corporate office with an employment contract.

- 1 company provides no information about any such combination.

- 4 companies say that some of their executives who hold corporate office also have an employment contract:
  - 1 company said explicitly that it intended to terminate the employment contract of its chief executive at the end of 2009 because he was retiring[32].
  - 1 company immediately applied the non-combination rule: the employment contract was terminated when the executive director in question resigned voluntarily.
  - 2 companies said they had decided to maintain their executives' employment contract.

These last two companies explain their decision as follows:

(i) The first says that "in light of the specific characteristics of the management team […], drawn from the Group's rank and file," this provision of the AFEP/MEDEF Code does not apply. It also specifies that the employment contracts of the chairman of the board of directors and the chief executive have been suspended and contain no provisions regarding termination payments. In a news release in February 2009 the company expressed reservations about this aspect of the AFEP/MEDEF Code.

(ii) The second company states that its chief executive has an employment contract with the group's lead holding company. The chairman of this company's compensation committee sought the opinion of the MEDEF blue-ribbon panel on the compensation of its chief executive. The panel noted that the executive had an employment contract, in breach of the AFEP/MEDEF Code. In its registration document the company explains why it is maintaining the contract. It says that the chief executive of the group is paid by the holding company under the terms of an agreement whereby the latter provides the company with specific resources and skills. This organisational structure safeguards the company's independence and allows it to "pursue a long-term strategy, ensure management continuity and secure its long-term future". Moreover, the chief executive of the company provides his services "free of charge".
It should be noted that the holding company bills the company for those services and that the chief executive holds options on the company's stock in his capacity as one of its executive directors.

2. FINAL ELIMINATION OF ANY UNFAIR TERMINATION PAYMENTS

- 4 companies say their executives do not receive termination payments.

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[31] Note that this measure in the AFEP/MEDEF Code applies to the chairman, to the chief executive officer of companies having a board of directors, to the chairman of the management board, to the sole managing director of companies having a management board and a supervisory board, and to statutory managers of limited stock partnerships.

[32] This company gave no information about an employment contract for its new chief executive, formerly the deputy chief executive, who was appointed upon retirement of the chairman and chief executive.

- The manager of one company who was entitled to a termination payment has expressly waived that right. His decision was approved by the board of directors.

- 3 companies indicate that some or all of their executives may qualify for termination payments as corporate office holders. These payments are capped at two years' fixed and variable compensation.
  All three companies give details of the performance requirements applicable to termination payments. The criteria applied by two of the companies are based directly on the quantitative factors used to determine the variable remuneration of the managers in question (EBITDA, operating profit, cash flow, net income, return on capital employed) over the three full financial years before termination. The performance requirement adopted by the third company is the annual increase in the group's consolidated operating income over the three full financial years before termination.
  The manager of one of these companies would qualify for a termination payment if he leaves office, provided he fulfils his performance requirements, even though he is entitled to exercise his pension rights in the near future. The AFEP/MEDEF code rules out termination payments in these circumstances.

Regarding non-competition indemnities, five companies say they do not make such payments to their executives; one gives no information on the matter; and two say they plan to pay an indemnity. One of the latter two companies gives no indication of how much it will pay, while the second limits the indemnity to one year's fixed and variable compensation.

3. STRENGTHENING THE SUPERVISION OF ADDITIONAL PENSION RIGHTS

- 7 of the eight companies say they operate a defined-benefit pension scheme for their senior managers. In their registration document they provide information about how these benefits are determined and calculated.

- 4 of the seven companies that operate a supplementary pension scheme indicate that the executive directors are not the only beneficiaries. Two say that the supplementary scheme applies to executive directors only. One company gives no information on this point.

- 4 companies out of the seven state that the reference period for benefit calculations is three years. The other three given no information about the reference period.

- None of the companies states explicitly in its registration document that the potential annual benefits of the scheme account for only a "limited" part of the beneficiaries' fixed compensation, as the AFEP/MEDEF Code recommends; neither do they state that the scheme has been counted as a benefit when determining the compensation package of the executives concerned. However, three of the companies explain how the benefits are calculated and state the percentage of potential rights for each year of service with the company. For the three, the percentage of potential rights varies between approximately 1% and 2%. The other companies simply give the maximum percentage of the reference salary that the beneficiary may receive upon retirement. In all cases, the annuities paid to scheme beneficiaries are capped.

- Only two companies state the seniority (i.e. length of service) requirements needed to qualify for a supplementary pension scheme (8 and 10 years). A third states that "although the scheme does not set a minimum seniority requirement, it is compliant with the spirit of the AFEP/MEDEF recommendation insofar as rights are vested gradually for each year of seniority at the rate of 1.2% per annum ".

- 5 companies say the beneficiary must still be with the company when he or she exercises their pension rights. The other two give no information on this point.

4. DETERMINATION OF ADDITIONAL RULES RELATING TO STOCK OPTIONS AND THE AWARD OF PERFORMANCE SHARES

- 7 out of eight companies say they have a policy for granting stock options and/or performance shares to their executive directors. Four of the seven made such grants in the past financial year.

All of the sample companies that operate a policy on option or performance-share grants to executive directors have adopted the standard tables recommended by the AMF for giving details of these compensation items.

- 2 companies say that the board has examined the allotment of new options and shares in light of the items of compensation paid to the executive in question. Both companies set a maximum percentage of compensation (in line with market standards) for share and option grants, measured according to IFRS.

- 4 companies set a maximum limit on options and shares grantable to executive directors, stated as a percentage of the overall allotment voted by shareholders.

- 4 companies make grants during the same period of the year, after the financial statements for the previous year have been published.

- 2 companies say they do not apply a discount to option strike prices. The remaining companies do not give any information on this point in registration document.

- 2 other companies state that executive directors are not permitted to hedge their options.

One company's registration document states that, in conformity with discussion area 2 in the AMF report[33], the executive "has undertaken not to use hedging instruments on the stock options or performance shares granted to him throughout his period in office ".

- Of the three companies that granted stock options for FY2008/2009:
  - 2 say they impose performance requirements on the exercise of all options;
  - 1 says it imposes performance requirements on only 50% of the options granted to its senior manager, and that the grant was made in January 2009 (i.e. after publication of the AFEP/MEDEF recommendations whereby all options should be subject to performance criteria).

- 2 companies awarded performance shares in FY 2008/2009 but only one says it applies performance requirements to all performance shares awarded to executive directors. The other company gives no information on this point.

- The companies that give details about performance requirements for exercising some or all options or for acquiring shares say that they apply:
  - either internal performance criteria: increase in sales, net income, operating margin; or a combination of these;
  - or external performance criteria: share price performance relative to the CAC 40 index.

- 4 companies require their senior executives to hold a given number of the shares they have acquired until they leave office.

- 3 companies state that their executive directors are not entitled to exercise their options during certain period, or refer to the board's rules of procedure, which sets lock-up periods. The other companies give no information on this point in their registration document.

5. COMPENSATION OF NON-EXECUTIVE CHAIRMEN

The AMF has examined the remuneration of six non-executive chairmen of sample companies. Two companies supply no information about the items of compensation paid to the chairman of their board of directors. Moreover, the methods of compensating non-executive chairmen vary considerably from one company to another.

The AMF repeats its suggestion that a debate should be launched on compensation arrangements for non-executive chairmen, taking into account the diverse situations and variety of functions they carry out (discussion area 4 in the AMF report published on 9 July 2009).

[33] AMF report on executive compensation in listed companies and implementation of the AFEP/MEDEF recommendations, published 9 July 2009.