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Online submission: <http://www.sai.consob.it/web/sai/consultazioni>
Brussels, 12 May, 2014

Subject: CONSOB Public consultation on Communication with respect to indemnities and severance in case of early termination of executive employee contracts.

Dear Sir/Madam,

We thank CONSOB for the opportunity to provide feedback on the proposed new communication requirements regarding severance payments (the "Communication"). ISS believes that disclosure is a key aspect of good corporate governance as it allows all shareholders to be properly informed of important aspects of company practices. We also recognize that termination agreements and payments to executives are topics that are of justifiable interest to shareholders and often raise attention among the investment community.

Q1. Condividete la scelta di differenziare l'ambito applicativo delle richieste informative e raccomandazioni in ragione dell'appartenenza delle società all'Indice FTSE Mib? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

According to the Communication, issuers listed on the Italian main index FTSE Mib would be required to disclose information on severance payments approved for executives whose employment contract has been terminated. The communication to the market would be issued the day after the board meeting deciding on said payments. Issuers listed on other Italian market indices would be recommended to disclose such information.

ISS Comment

ISS considers that the disclosure requirements referred to by the Communication for FTST Mib companies are appropriate and will be helpful for shareholders. ISS also believes that the same

information referred to by the Communication should be disclosed by a wider group of companies, not just those on the main index. We would therefore stress the importance for all public companies, including but not limited to those listed on the Italian main index, to comply with the recommendation issued by CONSOB.

Based on the number of minority shareholders participating to the capital structure of mid-cap companies, we consider that disclosure of information on severance payments would be particularly important also to issuers listed on the FTSE Italia Mid Cap index.

Q2. Condividete la scelta di prevedere che le richieste informative e raccomandazioni siano sottoposte alla sunset clause che ne fissa la validità fino alla fine del 2015? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The consultation document proposes that the Communication would be effective only until Dec. 31, 2015 (sunset clause), after which date the Italian market regulator CONSOB would assess the basis for a potential update of its issuer and related-party transaction regulations.

ISS Comment

Considering that the proposed Communication would be issued in the summer 2014, its total validity would run for about 18 months, after which it appears that there would be a gap while CONSOB assesses the basis for a potential update of regulations. We would suggest that CONSOB considers keeping the proposed Communication in effect until it has carried out its assessment and enacted any relevant update to the relevant regulations.

ISS would also suggest that for the purposes of the assessment that will be run after Dec. 31, 2015, CONSOB should take into account similar information provided by Italian issuers in the past (at least since the advisory Say-On-Pay vote was introduced into Italian law).

Q3. Ritenete adeguati gli elementi indicati dalla comunicazione con riguardo al contenuto delle indennità o altri benefici (cfr. Supra, punto 2.1, lett. A)? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The proposed Communication would require or recommend (depending on index of listing) that adequate information is disclosed about severance and other indemnities, including the amount, the timing of payment (detailing the sum paid up front and those deferred), and claw-back clauses with particular reference to:

- Early-termination indemnities;
- Continuation to participate to long-term incentive plans and continuation of rights on share-based financial instruments;
- Post-termination benefits;
- Non-competition agreements;
- Any other paid amounts notwithstanding its terms, legal classification, or economic rationale.

ISS Comment

We consider that the information listed by the proposed Communication could be helpfully supplemented by some additional areas of focus as follows:

- The events that have triggered the severance payments.
- Whether the outgoing executive had an employee contract with the company and whether severance payments are made on the basis of the employee contract and/or for the capacity as board member. In Italy employee contracts can be maintained and summed to the capacity as board members, while in other countries (e.g., France) work contracts are often cancelled or suspended prior to the appointment as executive director.
- Whether the severance payments are for an outgoing non-executive director. According to the information provided by some issuers in their remuneration reports, non-executive directors may sometimes be entitled to termination provisions. Granting termination payments to non-executive directors occurs rarely and is not consistent with Italian market standards. Although the Communication would target only executives, disclosure would be more complete if information on severance payments made to non-executive board members was also provided.
- Whether the beneficiary of severance payments will continue working at the company under any capacity (including any consultant contract).
- The components of the executive pay that have been taken into consideration for the calculation of the ultimate severance payments ("reference remuneration"): fixed salary, short- and/or long-term variable remuneration (at target or effectively earned), the period considered for the paid compensation used to calculate the termination indemnities, exceptional bonuses, equity awards.
- The multiples (in months or years) of the reference remuneration.
- If a bonus has been paid with respect to the fiscal year during which the employee contract has been terminated, whether the said bonus has been pro-rated.
- Whether any payments were approved to mitigate or release either the employee or the company from legal claims (potential or existing).
- Whether any payments were approved outside the contractual obligations.
- Whether termination indemnities are in addition to or in replacement of what already mandated by the national collective agreements. In Italy, any employee contract is subject to mandatory termination provisions included in national labor agreements. As such, it is important for shareholders' understanding to separate the sums paid under the provisions of the national labor agreements from what has been granted in accordance to private agreements between the issuers and the executive employee.
- The length of the notice period and whether termination indemnities are in addition to or in replacement of the notice period.
- Whether termination indemnities are in addition to or in replacement of non-competition agreements.
- Duration and geographic scope of non-competition agreements and whether the indemnities will be paid before or after the end of the non-competition period.

Q4. Ritenete adeguati gli elementi indicati dalla comunicazione con riguardo alla deliberazione delle indennità o altri benefici (cfr. Supra, punto 2.1, lett. B)? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The proposed Communication would require or recommend that issuers disclose whether termination payments are in accordance with the remuneration guidelines approved by shareholders or whether there have been deviations. In case of deviation, issuers should outline the decisional flow used also in accordance to the national rules on related-party transactions.

ISS Comment

ISS is in agreement with this approach. Investors may also find it beneficial to receive a brief explanation even in case of no deviations: issuers could explain how the severance payments fit in the broader context of the company's remuneration policy (i.e., indication of the relevant remuneration report and page or section). This further provision would increase easy access to the pertinent source of information without imposing additional burden to issuers.

Possibly, CONSOB may want to think of a standardized table that issuers should include in their remuneration policy section on termination arrangements. The same table would then be used ex-post by issuers, when severance payments are made, to clearly indicate whether or not deviations were made. If deviations were made, they would need to be explained.

Q5. Condividete la scelta di richiedere se e con quali esiti sia stata valutata l'applicazione di meccanismi che pongono vincoli o correttivi al trattamento da corrispondere all'amministratore/dirigente cessato (cfr. Supra, punto 2.1, lett. C)? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The proposed Communication would require or recommend that issuers disclose whether the any claw-back or ex-post adjustments have been applied, also in light of the recommendation contained in the Italian Code (6.C.1.f: "Termination payments shall not be paid if the termination is due to inadequate performance").

ISS Comment

Generally, shareholders consider that executive remuneration, thus including termination payments, should be aligned with company performance, particularly to avoid "pay for failure". As such, corporate results should be taken into account when determining the amount of termination payments if termination is due to inadequate performance.

For instance, the inclusion of performance conditions in executive contracts has been mandatory by law in France since 2007, and shareholders vote on such contracts each time a top executive (not necessarily a board member) is appointed. The criteria included in French executive contracts consider company performance over a multi-year period, and most large-cap issuers would disclose the precise definitions of the criteria as well as minimum target thresholds. When there are multiple performance indicators, the individual thresholds per indicator and formula would usually be disclosed.

ISS believes that issuers should explain the elements that have been taken into account for the claw-back and/or ex-post adjustments and the basis on which the final amount has been

calculated. The board should state whether it has applied any upward or downward discretion in determining the final severance payments.

Q6. Condividete la scelta di richiedere informazioni in ordine alla sostituzione dell'amministratore o altro soggetto cessato (cfr. Supra, punto 2.1, lett. D)? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The proposed Communication would require or recommend that issuers disclose any existing succession plans as well as actions put in place to replace the outgoing executive(s).

ISS Comment

ISS agrees on the importance of timely disclosure to shareholders regarding the measures related to succession plans, and has no further comments on this question.

Q7. Condividete la scelta di richiedere che il pubblico sia informato circa le valutazioni eventualmente formulate dall'organo di controllo (cfr. Supra, punto 2.1, lett. E)? Se no, quale diversa soluzione ritenete preferibile e per quali ragioni?

The proposed Communication would require or recommend that issuers disclose any assessment and comments issued by the supervisory board or the board of internal auditors.

ISS Comment

ISS agrees with this proposal and has no further comments on this question.

Q8. Avete ulteriori considerazioni sul tema in esame da segnalare?

Do you have more thoughts on the topic in question to report?

ISS Comment

ISS would suggest that the information disclosed under the provisions of the Communication should remain available to shareholders on the company website at least until the following annual general meeting. In addition, the terms of the existing severance agreements should also be available on the company website for the whole duration of the executive mandate. Companies may want to create a specific Executive Remuneration section in their website.

In addition, while the proposed Communication refers to ex-post disclosure, we believe that the final severance payments should be easy to quantify, even if approximately, also ex-ante. Shareholders should have visibility on the elements that would be taken into account for the calculation of the severance payments. The compensation guidelines proposed to shareholders in the annual remuneration report should detail upfront the exact terms of the potential severance payments, with all the possible components. This approach would allow avoiding boiler-plate explanation ex-post, whereby a company might simply state that the termination payment was made in accordance with the general terms approved by shareholders.

ISS would like to stress the importance to prefer substance over formality to maximize the quality of information to shareholders: disclosure to the market should be adequately

comprehensive, relevant and useful, rather than a simple outcome of compliance with a check list.

We remain at your disposal if CONSOB or other market participants would like to discuss anything in further detail.

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