

CONSOB'S CONSULTATION ON DIRECTOR REMUNERATION, BOARD PERFORMANCE EVALUATION, AND SUCCESSION PLANS

ISS has analyzed the document that CONSOB submitted to public consultation on Jan. 18, 2011, and is glad to contribute with its comments.

Q1) Condividete la decisione di intervenire in via transitoria con richieste e raccomandazioni in tema di trasparenza sulle aree oggetto della comunicazione?

The European Commission issued some recommendations on director remuneration at listed companies in April 2009¹. Although these recommendations are not binding, Member States were invited to implement them by Dec. 31, 2009. While the proposals put forth by the European regulators haven't been incorporated into national legislation by most countries, they've launched a wide debate. Most Member States have taken a long-term view, and are waiting to see the outcome of the legislative changes that are taking shape at the European level.

In the meanwhile, the Italian regulators have been shaping a commendable legislative package, targeting both banking and non-banking institutions. The provisions included in this draft proposal would allow for a better disclosure on remuneration and board practice. This enhancement would set the ground for an accurate assessment of what legislative tools the Italian regulators may want to introduce in the future. Disclosure is a key element to make effective and valuable the "say on pay" provisions that will become effective for all Italian listed companies in 2012.

On the whole, ISS appreciates the decision taken by CONSOB to launch a public debate on the issues included in this consultation and commends the scheme to introduce disclosure changes effective from the 2011 proxy season. ISS suggests that, after a thorough assessment following the 2011 proxy season, CONSOB should consider introducing the disclosure provisions included in this consultation in the definitive legislative measures that it will issue for the 2012 proxy season.

Q2) Condividete la scelta delle informazioni richieste in tema di accordi che prevedono indennità in caso di scioglimento anticipato del rapporto?

The Italian Financial Unified Code requires listed companies to disclose in their annual report detailed information on severance agreements between the company and its directors (TUF, article 123-bis, item 1, letter i).

We note that it is difficult to assess this element because companies usually don't provide full disclosure on executive contracts. As the consultation document correctly points out, it is often impossible to determine whether several elements of the severance package don't exist or simply aren't disclosed. Even when this information is provided, the real impact of severance payments can rarely be determined, due to the lack of detailed elements (amount of the severance payment, special bonus, non-competition agreements, and exercise of stock-based incentive instruments, etc.).

CONSOB is proposing to require that issuers disclose a) the existence (or non-existence) of severance agreements, b) details on severance payments, the way they are calculated, and their theoretical value at fiscal year-end, c) effects of early termination on the exercise of stock-based instruments, d) the requirements for severance agreements to become effective, and e) the existence (or non-existence) of postretirement perks and/or other consulting contracts.

ISS agrees with these proposals. Moreover, ISS supports severance payment to a maximum of 24 months' pay, in line with international best practice. We also note that severance payment is capped at 12 months in Belgium (up

¹ Recommendation (2009/385/CE) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies.

to 18 months under some conditions) and that best practice in the UK sets severance pay at 12 months of basic salary.

Finally, ISS believes that issuers should disclose any other post-retirement agreement that may have an impact on executive remuneration such as, and not limited to, non-competition clauses.

Q3) Condividete la scelta delle informazioni richieste in tema di piani di successione?

The Italian legal framework lacks any provision with respect to the disclosure of succession plans. It is important that large companies whose shareholder structure includes international investors communicate their succession plan. This kind of disclosure increases the company's stability and credibility, and allows avoiding emergency situations.

We agree with the proposal to require FTSE MIB companies to publish a) existence of a succession plans; b) the boards, committees, or other internal and/or external advisors involved in shaping succession plans; and c) succession plans' review practice.

Q4) Condividete la scelta delle informazioni richieste in tema di autovalutazione del Consiglio di amministrazione?

The Italian corporate governance code includes a provision on board performance evaluation. The board should perform an annual evaluation on its size, composition, and procedures (including committee working). It should also evaluate the need of professional skills and disclose the tools used and the outcome of this evaluation.

Due to the unbinding nature of the code, issuers may adopt this provision on a comply-or-explain basis. Moreover, this provision is rather lenient and allows wide discretion to issuers. As a result, most companies provide no or limited information on this issue.

However, disclosure on board composition and practice is necessary for a complete assessment of a company's corporate governance system. Therefore, ISS strongly supports the proposals to require FTSE MIB companies to disclose more information on the annual board performance evaluation (e.g., who organizes it, what tools are used, which are the strengths and areas of improvements, etc).

Adhering to the principle that substance should prevail over formality, ISS believes that the performance evaluation should focus on the inner functioning of the board: size and composition of the board (diversity and strengths of skills and experience); board and committee working (roles of chair, CEO, independent directors, and committees; flow of information; decision processes); communication with shareholders and stakeholders, board discussion on the results of the evaluation (possibly mediated by external consultants).

It is also of fundamental importance to the substantive efficacy of such a performance evaluation that a description is provided about its findings and the measures taken or to be taken as a follow-up and subsequent reporting of the prosecution of those measures.

Q5) Condividete la scelta di indirizzare le richieste in tema di piani di successione e di autovalutazione alle sole società del FTSE MIB?

ISS believes in particular that these provisions could be extended to those issuers belonging to the second main Italian index (FTSE Italia Mid Cap) or to the companies belonging to the STAR segment. The FTSE Italia Mid Cap index includes some 60 companies that often have a dynamic and international shareholder structure and business activity. Companies listed on the STAR segment have a medium capitalization and voluntarily commit to align their corporate governance to international standards. We see the potential for a high corporate governance improvement at these companies. Therefore, the proposed disclosure requirements may constitute a useful tool to improve their corporate governance practice.

Finally, ISS envisages that these provisions (more disclosure on succession plans and board performance review) shall be incorporated into the legislative instruments that will be implemented in 2012 and that shall apply to all Italian listed companies.

Q6) Condividete il contenuto dell'analisi costi-benefici realizzata?

ISS agrees with the cost-benefit analysis included by CONSOB in its consultation document.

We believe that this set of proposals has the potential to increase disclosure at Italian issuers and to bring it in line with standards applied by other European markets where corporate governance practices are more advanced.

The recent financial crisis has increased the need to restore investors' trust in issuers and to respond to investors' concerns on pay practice and performance. Confidence can be enhanced by demonstrating solid guarantees against the risk of pay-for-failure. Therefore, companies are urged to adopt remuneration practices that include clear links to performance. Better disclosure has the power to allow for a thorough analysis of executive and director remuneration, thus eliminating the informational asymmetry on the key issues tackled by this consultation.

Q7) Ritenete ci siano altri aspetti nell'ambito dei meccanismi di remunerazione e di funzionamento del consiglio di amministrazione su cui sarebbe opportuno intervenire con specifiche richieste e/o raccomandazioni nell'ambito della comunicazione?

CONSOB's current issuers' regulation requires companies to provide in the notes to their financial accounts details on remuneration received by directors and top executives. Annual reports therefore regularly contain individual information on director remuneration: fixed salary, benefits in kind, bonus, and other remuneration.

Remuneration components are however often provided in aggregate amounts. It is therefore very difficult to perform a peer comparison and to assess the link between performance and executive/director remuneration. The absence of details on other remuneration (including non-standard remuneration components such as special bonuses, retention bonuses, transaction bonuses, one-off rewards, etc.) prevents shareholders from getting a clear picture of remuneration packages leaving doubts about whether there has been a compromise of the directors' independence.

ISS agrees with the requirements to provide a detailed breakdown regarding the components of the fixed and other remuneration.

Moreover, we believe that, at a minimum, issuers that are part of the FTSE MIB index should provide details on the annual variable part of directors' remuneration (performance criteria, target objectives, and weights). With respect to executive long-term incentive plans, companies should provide disclosure on performance criteria (including target objectives and weights), vesting thresholds, vesting period, exact volume of the plan, pricing, and the possibility of retesting.

ISS views CONSOB's initiative to consult the market players prior the issuance of the new provisions positively, and we thank you for allowing us to participate in this process.

We remain at your disposal should clarifications be necessary on the comments included in this document. Please do not hesitate in contacting us.

Brussels, Feb. 7, 2011