



European Investors

<company name>

FAO: Members of the Board

<address>

<ZIP code> <city>

Brussels, 1 December 2016

Re: European Investors key areas for shareholder dialogue in 2017

Dear Members of the Board¹,

European Investors values clear and constructive dialogue between members of the Boards, both executive and non-executive, and shareholders.

Key areas

In the run up to the 2017 General Meeting of Shareholders (general meeting) the European Investors' Association (European Investors) would like to inform you of the key areas to which the European Investors would like to see more attention given in the coming year. European Investors has identified the following key areas.

- I. Impact of climate goals
- II. Dividend policy/capital allocation
- III. Cyber security

I. Impact of climate goals

More than ever before investors are becoming aware that climate change has a major impact on their investments. With the Paris Climate Agreement that entered into force on 4 November 2016, a vital step has been taken towards reducing global warming.

The agreements made a year ago will have a serious impact on almost every listed company. A distinction needs to be made here between the effect of the strict legislation which may be expected, the transition which companies must make to help achieve a CO₂-neutral environment and how these factors will impact on cash flows, balance sheet items and profitability.

Given the complexity of this topic, the company management needs to provide investors with clear, reliable and comparable information in its reporting. European Investors considers information on the following aspects to be essential:

¹ For the purposes of this letter, the Board is assumed to comprise both executive and non-executive directors. In case of a two-tier Board, this letter is meant for both the members of the Executive Board as well as the members of the Supervisory Board. The term 'non-executive directors' in such case refers to the members of the Supervisory Board.

- The method used by the management to quantify the opportunities and risks related to climate change. Most particularly, information will be required about the valuation aspects of climate-related balance sheet items, such as oil or other reserves, loans and provisions. Wherever possible, the company management should provide a comparison of these aspects relative to its peers.
- The Board's vision on climate-related opportunities and risks in terms of the company's earning model and how the management and organisation of the company needs to be adjusted in response to these.
- The aspects summarised above should be as quantitatively interpreted as possible, in line with the recommendations of the Task Force on Climate-related Financial Disclosures set up by the Financial Stability Board, and which form an integral part of the financial reporting. A scenario analysis may be used for this.

II. Dividend policy/capital allocation

Dividend is also an important part of the total return on the investment. Shareholders are nevertheless very well aware of the fact that a responsible dividend policy leads to the best results in the long term.

A recent survey by the Dutch Investors' Association VEB, one of the founding members of European Investors, showed that the dividend policy of many listed companies is vague and not tailored towards (potential) value creation by the company.

Most listed companies provide shareholders with no insight into the considerations made when deciding between paying dividend or reinvesting in the company - such that the return on the investment should be more than the capital costs if commercial value is to be created. Companies also provide insufficient information about the underlying considerations when dividend is paid instead of (i) investing, (ii) buying shares, (iii) settling debts, or (iv) making an acquisition.

European Investors calls on the Board of listed companies to provide clear information in both the annual report and during the general meeting about how the stated dividend policy is in line with the goal of creating value in the long term. In substantiating any dividend payment the company should explain why this is clearly preferable over any of the above four alternatives for allocating surplus profit (cash in hand). It is essential that a detailed explanation be given based on factors which are specific to the company, such as its earning model, potential value creation capacity and investment opportunities.

European Investors also takes the view that the principle of value creation applies not only to the dividend policy, but could also be more clearly reflected in the board remuneration policy. European Investors specifically requests that listed companies provide a clear explanation of the economic rationale for certain remuneration criteria used to calculate the variable remuneration elements (both long and short-term).

III. Cyber security

Companies are increasingly faced with cyber crime, in which both the frequency and seriousness of such incidents are on the increase. IT security therefore needs to become an intrinsic part of a company's risk

management at board level. Investors are entitled to expect that the Board has developed a cyber strategy which addresses and minimalizes the material consequences of IT incidents, and that they should be informed of this. European Investors requests that you give particular attention to the following aspects:

- Investors consider it necessary that a company which is heavily dependent on IT has a working group responsible for IT security, in which the Board or management team is represented by at least one person with a relevant background and competences in the field of IT security. Similar expertise should also be present among the non-executive directors of such businesses.
- Investors need to be sure that the Board sees to it that it is regularly and as fully informed as possible about the IT risks to the company. Ideally, independent external experts should also be involved in this.
- It is essential for investors that businesses provide transparent reporting on material IT risks and incidents. A good way to do this is to quantify performance criteria in the area of IT security. This would cover the number of vulnerabilities and IT incidents discovered in the company. The costs incurred to identify and remedy such vulnerabilities and incidents should be reported and substantiated in proportion to the damage which might have been incurred had any such vulnerabilities been exploited or incidents occurred. At the same time, information should be provided about the recovery time that a company would require following a possible cyber attack.

Non-executive directors' obligation to gather information

Non-executive directors play a pivotal role in striking the right balance between the interests of shareholders and the company. They constitute an indispensable line of defence tasked with the critical assessment of the governance of the company, its business models and the robustness of its strategy and risk management practices.

The tasks and responsibilities of non-executive directors are growing in both volume and complexity. It is no longer sufficient simply to blindly trust the information provided by the company. A modern non-executive director obtains information from multiple sources, analyses the attendant factors and actively seeks out the critical issues to ensure that the company has a sustainable earning model and that the company's management is appropriately challenged in its task of setting out the long-term future direction of the company.

European Investors considers this 'obligation to gather information' by non-executive directors to be a necessary requirement if a non-executive director is to fulfil his or her role and position as fully as possible. European Investors requests that non-executive directors make clear in the reporting how they have met this obligation.

One-on-One

Finally, one last point to consider. European Investors takes the view that the general meeting should serve as the focal point of the discussion between shareholders, executive directors and non-executive directors. There will be, of course, certain exceptions where it may be useful to provide information on complex matters (e.g. the remuneration policy) and to exchange thoughts on the matter in advance of the general meeting. European Investors is always available and open to discussion on such matters.

European Investors hopes to receive a transparent annual report and looks forward to a fruitful discussion at the general meeting of shareholders.

Yours sincerely,

European Investors' Association (European Investors),



P.M. Koster,
Chairman