

## **DIRECTORS' REPORTS ON THE PROPOSALS ON THE AGENDA OF THE ORDINARY GENERAL MEETINGS OF THE SHAREHOLDERS**

**(11<sup>TH</sup> APRIL 2019 SINGLE CALL)**

### **Report on item 2 on the agenda of the Ordinary Shareholders' Meeting**

**Remuneration policies in accordance with article 123-ter of Legislative Decree No. 58 of 24<sup>th</sup> February 1998; relative and consequent resolutions.**

To Our Shareholders,

In compliance with article 123-ter of Legislative Decree No. 58/1998 (Consolidated Finance Act) and article 84 *quater* of the Issuers' Regulations issued by the Consob with Resolution No. 11971 of 14<sup>th</sup> May 1999 and subsequent amendments (hereinafter the "Issuer's Regulations"), Section I of the Report on Remuneration is given below, approved by the Board of Directors on 28<sup>th</sup> February 2019, on the recommendation of the Remuneration Committee.

In accordance with article 123-ter, paragraph 6, of Legislative Decree No. 58/1998, the Shareholders' Meeting convened pursuant to paragraph two of article 2364, and that is to approve the separate annual financial statements, shall vote either in favour or against the section on the Remuneration Report required by paragraph three of that article, which is to say on the first section of the remuneration report. That section illustrates the following:

- a) the policies of the company on the remuneration of members of management bodies, general managers and senior executives with key responsibilities with reference to at least the subsequent financial year;
- b) the procedures used to set and implement that policy.

That vote is not binding. The result of the vote shall be disclosed to the public in accordance with Art. 125-*quater*, paragraph 2 of Legislative Decree No. 58/1998.

In consideration of the foregoing, the shareholders are invited to vote on the section of the Report on Remuneration specified in paragraph 3 of Art. 123-ter of Legislative Decree No. 58/1998.

The Report on Remuneration will be made available to the public within the legal time limits and may be consulted on the company website at [www.recordati.it](http://www.recordati.it) in the Corporate Governance Section.

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## Remuneration Policy for 2019

### **Procedures used for the adoption and implementation of the Remuneration Policy: bodies and persons involved to formulate and approve the Remuneration Policy and the bodies and persons responsible for the proper implementation of that policy.**

The Remuneration Policy is approved by the Board of Directors of the Company on the basis of a recommendation made by the Remuneration Committee, the composition, responsibilities and functioning of which is described in detail in the following sub-section.

After approval by the Board of Directors, the Remuneration Policy is subject to a non-binding vote by the Shareholders' Meeting held to approve the annual report.

The Remuneration Committee is supported by the Head of the Human Resources Department of the Group in the formulation of a proposal on the Remuneration Policy to be submitted to the Board.

While no specific intervention by independent experts occurred in the formulation of the Remuneration Policy, account was taken in its formulation of the salary policies pursued by other companies in the sector as constantly monitored by benchmarking salary surveys and by reports on executive remuneration and corporate governance prepared by leading consulting firms. The Remuneration Policy may be updated if necessary or appropriate by the Board of Directors, on the basis of a recommendation by the Remuneration Committee, which is responsible for periodic assessment of its appropriateness, overall consistency and concrete application, as described in detail below.

The Board of Directors complies with the Remuneration Policy, which takes account of conditions and practices for similar markets in defining the remuneration of the Chair and of the Chief Executive Officer and that of the other Directors occupying specific positions (*amministratori investiti di particolari cariche*) pursuant to article 2389, paragraph 3 of the Italian Civil Code and non-executive directors.

The Chief Executive Officer refers to the Remuneration Policy in setting the remuneration of key management personnel.

Without prejudice to the responsibilities of the Remuneration Committee, the Board of Directors is responsible for the following: (i) deciding, having heard the opinion of the Board of Statutory Auditors, the remuneration of directors occupying specific positions pursuant to article 2389, paragraph 3 of the Italian Civil Code; (ii) the allocation of the total remuneration for directors set by shareholders, if they have not done so; (iii) the examination of stock option plans to be submitted for shareholder approval and deciding the grant of options in implementation of those plans.

Furthermore the Board of Directors, supported by the Remuneration Committee, oversees the implementation of the remuneration policy.

### **The Remuneration Committee**

As indicated above, a proposal to the Board of Directors on Remuneration Policy was formulated by the Remuneration Committee.

The Company created a Remuneration Committee in 2001, in compliance with the corporate governance code recommendations. Furthermore, when the Related Party Transaction Regulations were approved, the Board assigned responsibility to the Remuneration Committee for the formulation of an opinion (non binding or binding according to the case) on related-party transactions concerning the remuneration of the members of the management and supervisory bodies and key management personnel, without prejudice to the provisions of Art. 2.01 f) of the aforementioned regulations.

The current Remuneration Committee was appointed by the Board on 5<sup>th</sup> February 2019 (following the Ordinary Shareholding Meeting that, on the same date, has appointed the new Board of Directors) and is composed by Mrs. Jo Le Couilliard, Chair, Mrs. Silvia Candini and Mrs. Michaela Castelli, all non-executive, independent directors and having specific expertise on financial matters.

The functions currently assigned to the Committee are as follows:

- to formulate proposals to the Board on policies for the remuneration of directors, key management personnel and, where appropriate, other senior managers of the Recordati Group;
- to periodically assess the appropriateness, overall consistency and concrete implementation of the policy for the remuneration of directors and key management personnel (and also, where appropriate, other senior managers in the Recordati Group), making use with regard to the latter of information supplied by the CEO, also through the Director of Group Human Resources;
- to submit proposals or express opinions to the Board of Directors on the remuneration of executive directors and other directors who occupy specific positions and on the setting of performance objectives in relation to the variable component of that remuneration; to monitor the implementation of decisions made by the Board itself, verifying the actual achievement of the performance objectives;
- to perform the functions assigned by the Board of Directors in relation to the administration of plans for the grant to employees and/or Directors of the Company and its subsidiaries of shares of the Company or options on them (stock options), without prejudice to the general responsibility of the Board itself for the supervision also of this matter;
- to express an opinion, either binding or not binding, on related-party transactions of major importance and on related-party transactions of minor importance respectively, regarding remuneration, in compliance with the Related-Party Transaction Regulations.

The proceedings of meetings of the Remuneration Committee are governed by the following rules (contained in the Committee's regulations approved by the Board of Directors):

1. committee meetings are chaired by the chair or, in the event of his/her absence or impediment, by the most senior member of the committee in terms of length of service on the Board of Directors, or in the case of equal length of service, the most senior by age;
2. responsibility for preparing minutes of meetings lies with the chair, who shall appoint a secretary from time to time, who may also not be a member of the committee and who is called upon to minute the meeting;
3. the committee shall meet, having been convened by notice in writing which indicates the place, day and time and agenda of the meeting to be given by the chair of the committee (or in the event of his absence or impediment by the most senior member of the committee in terms of length of service on the Board of Directors, or in the case of equal length of service, the most senior by age) at least two days prior to the date set for the meeting to be held either at the registered offices of the Company or elsewhere in Italy, as indicated in the notice to convene the meeting;
4. remote participation in meetings of the committee is also admissible by means of appropriate audio-video, teleconference or telephone links, on condition that all participants can be identified and that they are able to speak and at the same time examine the agenda and the related documents and pass resolutions on them. In these cases the meeting is considered as held in the place where the secretary is present;
5. the committee is constituted and passes resolutions with the attendance and vote in favour respectively of the majority of the members in office;
6. the Chair of the Board of Statutory Auditors or in the event of his absence or impediment another statutory auditor designated by him takes part in the proceedings of the Remuneration Committee in the capacity of a permanent guest. Other statutory auditors may in any case participate;
7. also the CEO and other corporate functions whose participation in meetings is necessary or appropriate in relation to the duties of the committee may be invited to participate from time to time on invitation of the committee and with reference to individual items on the agenda.

The Remuneration Committee has the right to access the corporate information and functions needed to perform its duties and also to make use of external consultants, under the terms and conditions laid down by the Board of Directors. The Committee has the right to ask for adequate funds to be made available to it to carry out its duties.

### **Objectives**

The objectives pursued with the Remuneration Policy are to set remuneration which meets the following requirements:

- to be sufficient to attract, keep and motivate managers with the professional abilities required to successfully manage the organisational and operational complexity of the Company and the Group;
- to align their interests with the pursuit of the primary objective of creating wealth for shareholders over a medium to long-term time horizon;
- to leave a significant proportion of total remuneration linked to the achievement of specific performance objectives, both qualitative and quantitative, set in advance, consistent with the lines of development of the Company and the Group.

### **Principles and criteria**

The underlying principles and governing criteria of the Remuneration Policy are as follows:

- to balance the fixed and variable components of remuneration appropriately in accordance with the strategic objectives of the Company and of the Group;
- to provide a fixed component of overall remuneration that is sufficient and appropriate to remunerate services in the event that the variable component is not paid, because of the failure to achieve performance objectives;
- to set maximum limits to variable components, by linking them to qualitative and quantitative performance objectives, set in advance, that are measurable and linked to the creation of wealth for shareholders in both the short and long term;
- to encourage the fidelity and protection of key Group personnel with incentives to remain with the Group.

### **Amendments to Remuneration Policy compared with the previous year**

The Remuneration Policy has been amended by the Board of Directors on 28 February 2019, following the proposal of the Remuneration Committee dated 25 February 2019, in order to take into due account the changes in the articulation of the top company figures that occurred after the change of control of Recordati S.p.A., with particular reference to the remuneration of the Chair of the Board of Directors and of the Chief Executive Officer, both no longer employed by the Company. Furthermore, certain provisions regarding the payment of the short-term variable remuneration and the allocation, exceptionally and on a non-recurring basis, of one-off bonuses and disbursements in favour of key management personnel, have been integrated.

### **Components of remuneration**

With regard to members of the Board of Directors, the total remuneration set for directors by shareholders is allocated among them by the Board of Directors on the basis of the following criteria: all directors are paid a basic fee, plus an extra amount for non-executive directors in relation to their appointment to each committee, with a further extra amount for non executive directors who occupy the position of chair on those committees.

Non-executive directors receive no other remuneration except for that described above and they are not therefore recipients of the benefits of the stock option plans in force.

The Chair, the Chief Executive Officer and, where present, the other Directors vested with special duties receive, in addition to the aforementioned basic remuneration, a additional remuneration determined by the Board, having heard the opinion of the Board of Statutory Auditors, pursuant to Article 2389, para. 3,

of the Italian Civil Code, and commensurate with the commitment required for the respective office, taking into account the market benchmarks.

The remuneration of the Chief Executive Officer - in addition to the fixed and variable remuneration of the executive Directors<sup>1</sup> – is composed of a severance payment (*trattamento di fine mandato*) and an exit payment in case of termination of the office (*indennità di fine carica*), as better illustrated below.

The overall remuneration of the executive directors of the Company – as well as the overall remuneration of the other key management personnel – is composed of a total fixed remuneration and, if the conditions are met, of a short term variable remuneration based on an MBO (Management by Objectives) scheme, along with a medium to long-term variable component of remuneration, based on stock option plans.

Where appropriate, further “on/off” objectives may be assigned to executive directors of the Company and to the other key management personnel, in addition to the MBO objectives in relation to projects of strategic importance for the Group.

As part of the process of appointing key management personnel, these persons may be paid a recruitment bonus in order to attract particularly high quality human resources. Further details are given below of the components of total remuneration for key management personnel, including the executive directors of the Company as far as applicable and as specified below.

- **Fixed remuneration**

The fixed component of remuneration of the key management personnel, the gross annual income, which is to say the contractually guaranteed annual remuneration is monitored for all top management positions by sector salary surveys and the amount is set, in order to meet the criteria of retention and adequate remuneration, at a competitive level on the market. For the Chief Executive Officer such fixed remuneration is represented by the basic remuneration granted to each member of the Board of Directors and by the additional remuneration determined pursuant to Article 2389, para. 3, of the Italian Civil Code.

The percentage of the fixed component of remuneration as part of the overall remuneration varies from year to year depending on changes in the other components of remuneration: the amount of the short-term remuneration linked to the MBO scheme varies from year-to-year depending on the degree to which the company objective and individual objectives are achieved as better described below. The amount of the medium to long-term variable remuneration resulting from stock option plans is linked to the performance of the Company's share price.

- **Short-term variable remuneration (MBO scheme)**

The variable component of remuneration for the executive directors and for the other key management personnel is linked to the inclusion of these roles in a management by objectives (MBO) incentive scheme.

On the basis of this scheme, a bonus is paid on the achievement of annual results defined with the Company and measured according to parameters and weightings set in advance. Bonuses are payable for individuals in amounts proportionate to the achievement of the results for the year in question and with a maximum ceiling equal to 30% of gross annual income (GAI), with the exception made for that which is stated below for the Chief Executive Officer, as well as for the General Manager for the Co-Ordination of Operations and Chief Financial Officer.

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<sup>1</sup> For the purposes of this Report, “executive directors” means directors who hold executive offices in Recordati S.p.A. Please note that the executive director Fritz Squindo is also an employee of the Company and, in the context of this employment relationship, receives an overall remuneration consisting of a fixed remuneration and a variable remuneration as described below.

The MBO scheme involves the assignment of three individual objectives for each person, each of which is associated with a measurement indicator: this indicator represents the reference parameter which, if reached, determines the percentage achievement of the objective to which it is related.

One objective (Group operating income) is common to all key management personnel and senior managers to which the self-financing principle of the MBO scheme applies. According to that principle, no expenses are budgeted for the variable component of salaries, which is therefore only paid if the Group objective for operating income is exceeded by at least an amount, based on actual results, equal to the variable remuneration to be paid to those persons.

The measurement indicator consists of a progressive scale the lower end of which corresponds to 100% achievement of the objective and the upper end of which corresponds to 110% achievement of the objective, the ceiling for each objective.

A value is associated to the measurement indicator along a predetermined progressive scale for each percentage level of achievement of the objective between 100% and 110%.

Different progressive scales of the measurement indicator are possible depending on the objective. Finally the measurement indicator is descriptive for qualitative objectives (not associated with quantitative measurement indicators, such as projects of particular importance to the Company).

Each objective is also assigned a percentage of importance (or weighting ratio, which represents the proportion of the objective out of a total of 100%).

The weighted average (according to the percentage weightings assigned) of the percentage achievement of the three objectives assigned gives the percentage achievement of the MBO objective of the person concerned.

The threshold to pass to receive a bonus consists of exceeding the weighted average of 100% (no bonus is paid on a weighted average of less than or equal to 100%), while for the maximum weighted average (110%) the maximum bonus of 30% of GAI is paid.

It is clear, with regard to the above, that by including the important Group operating income objective among the individual objectives of each individual concerned, Recordati's MBO scheme tends not to reward individual performance in itself so much, but rather individual performance in a context of operating results which will allow the bonus to be paid, in line with the principle of aligning management interests with shareholder interests with a view to pursuing the long term interests of the Company.

In consideration of the particular strategic importance of the positions held (i) the maximum bonus payable to the Chief Executive Officer is equal to 100% of the overall gross annual fixed remuneration (composed of the basic remuneration granted to each member of the Board of Directors and of the additional remuneration determined pursuant to Article 2389, para. 3, of the Italian Civil Code) for each financial year and (ii) the maximum bonus payable to the General Manager for the Coordination of Operations and CFO is 40% of GAI.

The right to the receipt of a bonus is acquired when the Board of Directors approves the consolidated financial statements from which achievement of the Group operating income objective set when the objective was decided is seen. The bonus is paid in the year in which the consolidated financial statements mentioned are approved. No reason can be seen, at present, to defer payment of the bonus with respect to the time when the right to receive it is acquired, because it forms part of a scheme which is already very challenging (see above for information on the self-financing nature of the MBO scheme) and because, with a view to continuity it lends itself to setting the same objectives each year. Furthermore, the main objective for key management personnel, which is budgeted Group operating income, is a target to which all the above persons contribute to achieving, without any single individual being able to influence that achievement exclusively. Finally, deferment of a part of variable remuneration is nevertheless guaranteed by the medium to long-term incentive scheme based on the grant of stock options, reported on below.

If the MBO target is not reached due to extraordinary and / or unpredictable factors, the Board of Directors, having heard the opinion of the Remuneration Committee, or the Chief Executive Officer with reference to the other key management personnel, have the right to evaluate the opportunity to pay, in whole or in part, the variable remuneration (MBO), taking into account, in any case, also the percentage of deviation from the target itself for quantitative objectives.



Exceptionally and on a non-recurring basis the Board of Directors, having heard the Remuneration Committee, or the Chief Executive Officer with reference to the other key management personnel, may grant any form of extraordinary compensation in favour of key management personnel, in the form of one-off disbursements, strictly commensurate to their specific contribution in relation to the achievement, or the manner of achievement, of particular objectives.

At present, no need can even be seen to insert criteria for determining conditions for the return of bonuses in contractual arrangements with executive directors, or those assigned particular duties, and with key management personnel, should it be discovered they were determined on the basis of data which was found subsequently to be manifestly inaccurate (i.e. “clawback” clauses).

This is because, in the absence of deferred payment of variable remuneration, and that is deferment that is not made for the reasons given above, the introduction of clawback clauses in the employment contracts of the senior managers in question would not only pose serious problems of interpretation and application, but would not provide an instrument for recovering the sums in question that is any more effective than the remedies available in existing law in the event of fraudulent conduct or gross negligence.

The objectives set for the head of the internal audit function and for the director responsible for drafting the Company’s financial reports (currently covered by the Chief Financial Officer) are consistent with the duties assigned to them.

- **Medium to long-term variable remuneration**

The medium to long-term incentive scheme adopted by the Company is based on granting stock option rights to key management personnel, included the Chief Executive Officer. The stock option plans adopted by the Company are available on the Company website at:

[http://www.recordati.it/en/corporate\\_governance/remuneration/stock\\_option\\_plans/](http://www.recordati.it/en/corporate_governance/remuneration/stock_option_plans/)

As is typical of these types of incentive tools, the beneficiaries are granted the right to purchase or subscribe a certain number of shares of the Company at a set price (the strike or exercise price), once a certain period of time has passed (the vesting period) and the condition for the achievement of the performance objective mentioned below has been satisfied. The right must be exercised before a specified expiration date (the end of the eighth year following that on which the options are granted).

The number of options granted to each beneficiary correlates with the importance of their position occupied in the organisation chart among the various senior management figures.

On the basis of the current stock option plans, options are generally granted on a two yearly basis and according to the plans, the exercise price is established on the basis of a fair market value calculation (the arithmetic average of the share prices quoted on the stock market in the period running from the grant date of the options and the same date of the previous calendar month). The total options granted to each beneficiary are divided into four equal tranches with four different successive vesting periods: the first tranche can be exercised (if the other conditions set by plans are satisfied) in the second year following that on which the options were granted; the second, third and fourth tranches may be exercised in the third, fourth and fifth years respectively following that in which the options were granted.

It is felt that the “staggered” vesting period described above puts a strong limitation on the likelihood that the beneficiaries of stock option plans will behave in a manner designed to increase the market value of shares in the short-term, at the expense of the creation of value over a medium to long-term time horizon.

An indispensable condition for the exercise of each tranche of options granted is the achievement of a performance objective which is based on the budgeted net consolidated income.

The existence of a performance clause in the stock option plan regulations also complies with the principle whereby the Remuneration Policy is consistent with the pursuit of the interests of the Company and its shareholders, which must coincide with the interests of the management.

The current stock option plans do not require the beneficiaries to continue to hold a portion of the shares purchased following the exercise of stock options. This is because it is considered that the structure of the stock option plans as described above, with a vesting period “staggered” over four years and expiration of

the options in the eighth year following that on which they are granted, is sufficient to ensure that priority is given to the creation of wealth for shareholders over a medium to long-term time horizon.

- **Extra performance clause**

In compliance with the underlying principles of the Remuneration Policy and in line with the objectives to attract, motivate and retain key personnel, exceptionally it is also possible to pay bonuses on a one-off basis, with a maximum ceiling of 100% of Gross Annual Income for the services of key management personnel (including the executive directors, for which reference is made to the overall gross annual fixed remuneration) defined as “extra performance”, which is to say performance significantly higher than the base parameters set for the assignment of both short and medium to long-term variable remuneration.

**Non-monetary benefits**

The Remuneration Policy does not contemplate particular non-monetary benefits other than those defined as standard for senior management position (e.g. company car).

**End of contract indemnity**

The Remuneration Policy does not provide for end of contract indemnities for non-executive directors.

As concerns other key management personnel, included executive directors, if it is considered to be in the best interests of the Company and in relation to the importance of a senior manager’s position in the organisation of the company, agreements may be entered into which involve the payment of special indemnities, usually equal to a certain number of month’s or year’s salary, if an employment relationship is terminated by initiative of the Company for reasons other than “just cause”; reference is also made here to the prevailing market practices at the time. In consideration of those practices no linkage is generally made between these possible payments and the performance of the Company. In particular, agreements providing for severance payment (*trattamento di fine mandato*) and exit payment in case of termination of the office (*indennità di fine carica*) for the Chief Executive Officer, as well as severance payment (*trattamento di fine carica*) for the General Manager for the Co-Ordination of Operations and Chief Financial Officer, has been entered into.

In all other cases, should an employment relationship terminate early for reasons other than just cause, key management personnel are paid an indemnity in accordance with the provisions of the law and of the national labour contract for the senior management of industrial companies in force and in some cases together with an additional amount calculated on a fair pay basis.

In the event of a director retiring from office and/or the termination of the employment relationship of an executive director or a general manager, on conclusion of the internal processes which lead to the grant or payment of indemnities and/or other benefits, the Company shall disclose detailed information on the matter by means of a press release to the market.

**Additional insurance, social security and pension cover**

No additional cover with respect to that which is compulsory by law or provided under labour contracts is provided by the company except for supplementary F.A.S.I. insurance to cover medical expenses and a D&O policy, as well as an insurance policy for the Chief Executive Officer to cover life risk, health risk, disability risk and injury risk.



Milan, 28 February 2019

For the Board of Directors  
The Chief Executive Officer  
Andrea Recordati