



**ERG S.p.A.**

## **Remuneration Policy**



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## 2017 Remuneration Policy

### 1. Evolution of Approach

In line with the provisions of the Corporate Governance Code<sup>1</sup>, the Board of Directors of ERG, **adopted**, with resolution dated 20 December 2011, upon a recommendation from the NRC<sup>2</sup>, its own Remuneration Policy, effective from 2012. The Policy's structure was independently defined by ERG at the time, without using as reference remuneration policies pertaining to other companies.

The Policy underwent an **initial revision** by the Board of Directors, on a proposal from the NRC, on 18 December 2012, to take account of the powers assigned by the Board of Directors – appointed by the Shareholders' Meeting of 20 April 2012 – and the adoption of the 2012-2014 LTI System. For such purpose, ERG used the services of the consulting firm The European House – Ambrosetti.

As part of the said revision of the Policy, several remuneration policies of non-financial FTSE MIB index companies were used as reference, since these were considered most representative of Italian best practices, as well as a peer group of parties (comparable to ERG based on their size and operating in sectors where the ERG Group is active) proposed by the consulting firm The European House – Ambrosetti.

On 11 March 2015, the Policy was subject to a **second revision** by the Board of Directors, upon a recommendation from the NRC, to take account, effective from 2015, of the Company's acceptance of the version of the Corporate Governance Code in force at that time and the general principles of the 2015-2017 LTI System, with a view to ensuring greater alignment of management's interests to the priority goal of creating value for Shareholders over the medium/long-term, in keeping with the strategic guidelines of the ERG Group. For such purpose, the Company used the services of the consulting firm The European House – Ambrosetti.

For the second revision of the Policy, in line with the

previous actions, the Company used as reference some remuneration policies of non-financial FTSE MIB index companies, since these were considered most representative of Italian best practices, together with a peer group of parties comparable to ERG based on their size and operating in sectors where the ERG Group is active, again as proposed by the consulting firm The European House – Ambrosetti.

- **Changes deriving from acceptance of the Corporate Governance Code**

In line with the provisions of the Corporate Governance Code currently in force, which the Company has accepted, the Policy sets forth a clause expressly recognising the Company's right to request the return of variable remuneration (or to withhold deferred amounts) where said remuneration is found to have been disbursed based on data that was subsequently found to be clearly incorrect (**clawback clause**).

- **Changes deriving from the 2015-2017 LTI System**

The main changes deriving from the 2015-2017 LTI System, developed according to a logic of continuity with respect to the 2012-2014 LTI System, include the introduction of a performance target linked to the trend in ERG's share during the three years of the reference period and the amount of dividends for share paid during the same period (Total Shareholder Return), in order to align the interests of the related beneficiaries with the interests of Shareholders, which is then added to the performance target expressed using the EVA (Economic Value Added) indicator, a parameter already used in the 2012-2014 LTI System.

The 2015-2017 LTI System was approved by the Board of Directors, upon a proposal from the NRC and having heard the favourable opinion of the Board of Statutory Auditors, on 11 March 2015 and subjected to the approval of the Shareholders' Meeting held on 24 April 2015 – which issued a favourable resolution to this effect – in consideration of the introduction of a performance objective connected to ERG's share. On 15 December 2015, the Board of Directors – in line with the Remuneration Policy 2015 and in the light of the 2015-2018 Business Plan approved at the same time – upon a proposal from the NRC and having heard the favourable opinion of the Board of Statutory Auditors, has specified the necessary conditions to implement the 2015-2017 LTI System.

<sup>1</sup> This refers to the version of the Corporate Governance Code published in December 2011.

<sup>2</sup> Further information regarding bodies and persons involved in the preparation and approval of the Policy and the NRC's composition, competences and working procedures is set out in the Report on Governance and Ownership drawn up pursuant to Article 123-bis of the Consolidated Finance Act (CFA).

The Policy was **updated**, upon a proposal from the NRC,

- on 22 March 2016, for the sole purpose of acknowledging the resolution of the Board of Directors dated 15 December 2015, which defined the conditions necessary to implement the 2015-2017 LTI System, in line with the said Policy and in view of the 2015-2018 Business Plan;
- on 9 March 2017 for the purpose of implementing the organisational changes following the reorganisation of the risk management, compliance and internal control processes of the ERG Group and the “ONE Company”<sup>3</sup> Project, as well as the introduction of a clause to which the deferred payment of any non-recurring remuneration is subordinated, after assessment of the NRC and resolution of the Board of Directors.

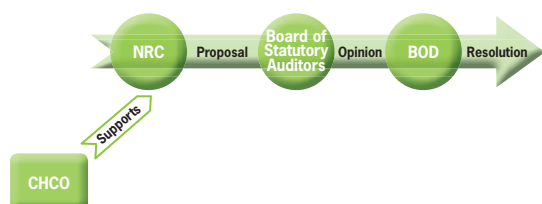
## 2. Parties involved

In keeping with relevant legislative and regulatory provisions in force and the recommendations of the Corporate Governance Code, the decisions behind the implementation of the 2017 Remuneration Policy and the responsibility for its correct application are the result of a joint process involving numerous parties:

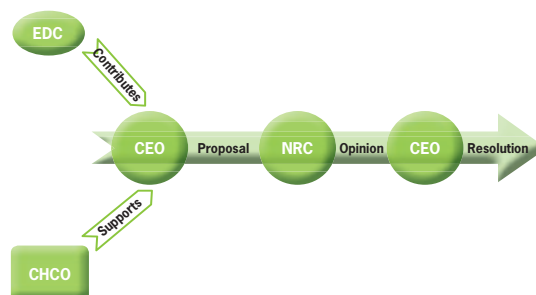
- a) The Shareholders’ Meeting, as regards the Directors’ fees and those of the Directors called upon to sit on the NRC or the CRC



- b) The Board of Directors, upon a recommendation from the NRC, with the support of the CHCO and having consulted the Board of Statutory Auditors, as regards the remuneration of Executive Directors or Directors holding specific offices as well as, if necessary, the directors called upon to sit on the Strategic Committee, where these are not employees of the Group and do not hold offices on the Board of Directors



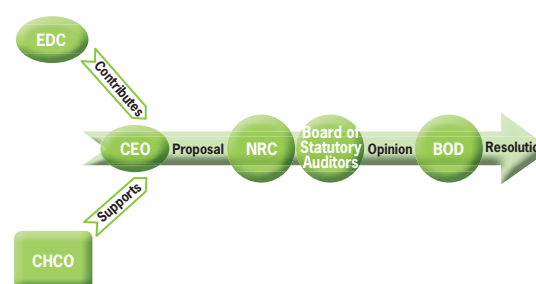
- c) The Chief Executive Officer, jointly with the Executive Deputy Chairman and with the support of the CHCO, having consulted the NRC, as regards the remuneration of Executives with strategic responsibilities<sup>4</sup>



- d) The Board of Directors, upon a proposal from the Director in charge of the Internal Control and Risk Management System, subject to the favourable opinion of the CRC and the support of the CHCO, having consulted the Board of Statutory Auditors, for the remuneration of the Chief Audit Officer, who is also an Executive with strategic responsibilities



- e) The Board of Directors, upon a proposal from the Chief Executive Officer, jointly with the Executive Deputy Chairman and supported by the CHCO, having consulted the NRC and the Board of Statutory Auditors, for the remuneration of the Manager Responsible for preparing the Company's financial reports, who is also an Executive with strategic responsibilities



<sup>3</sup> See Press Release of 10 November 2016.

<sup>4</sup> Subject to the provisions of point (d) below for the Chief Audit Officer and point (e) for the Manager Responsible for preparing company's financial reports.

## 2.1 Nominations and Remuneration Committee

The Nominations and Remuneration Committee comprises three non-executive directors, mostly independent, qualified as such pursuant to both the related provisions set forth by the Consolidated Finance Act (CFA) and those set forth by the Corporate Governance Code<sup>5</sup>, who have adequate financial and remuneration policy experience<sup>6</sup>.

The Committee meets at least once a quarterly. All members of the Board of Statutory Auditors take part in the Committee proceedings; in addition, the Chairman of the Board of Directors, the Executive Deputy Chairman and the Chief Executive Officer may participate, by invitation, insofar as they are entitled to intervene on the matters being considered and to identify suitable interventions to address situations, even if potentially critical. Directors do not take part in the meetings of the NRC where proposals are made to the Board of Directors in connection with their own remuneration. Employees of ERG Group companies, representatives of the independent auditor and, in general, persons whose presence is deemed necessary or appropriate for the discussion of the agenda items may be invited to attend Committee meetings.

As regards the remuneration of members of the **Board of Directors**, the Committee:

- periodically assesses the adequacy, overall consistency and concrete application of the Remuneration Policy, reporting to the Board of Directors
- submits recommendations or expresses opinions to the Board of Directors concerning the remuneration of Executive Directors or Directors holding specific offices as well as, if necessary, the remuneration of the Directors called upon to sit on the Strategic

Committee, where the same are not employees of the Group and do not hold offices on the Board of Directors

- submits proposals or expresses opinions to the Board of Directors on the setting of performance targets linked to the variable component of the medium/long-term incentive systems
- monitors implementation of the decisions taken by the Board of Directors, verifying the actual achievement of the performance targets.

As regards the remuneration of **Executives with strategic responsibilities**, the Committee:

- periodically assesses the adequacy, overall consistency and concrete application of the Remuneration Policy
- expresses opinions to the Chief Executive Officer on their remuneration
- submits proposals or expresses opinions to the Chief Executive Officer on the setting of Group performance targets linked to the variable component of the short-term incentive system
- submits proposals or expresses opinions to the Board of Directors on the setting of performance targets linked to the variable component of the medium/long-term incentive systems
- verifies the actual achievement of Group performance targets.

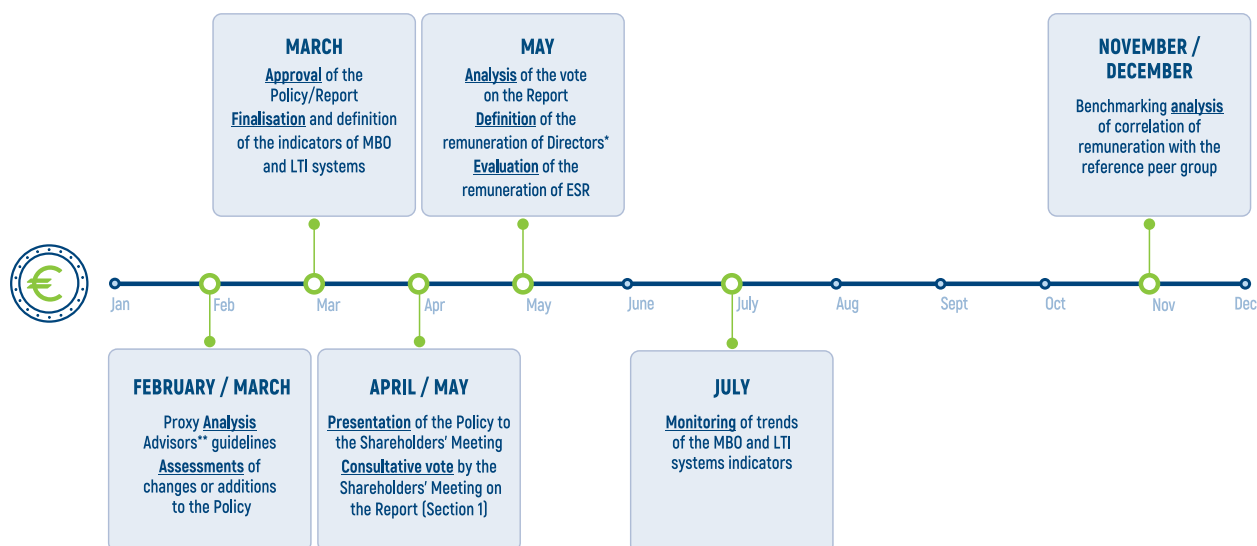
The Committee actively participates in defining the short and medium/long-term variable incentive systems.

In particular, the Committee was actively involved in the process of preparation and subsequent adoption of the MBO System, the 2012-2014 LTI System and the 2015- 2017 LTI System.

<sup>5</sup> It should be mentioned that the Committee Chairman, who is a non-executive director, was qualified by the Board of Directors of 24 April 2015 as an independent director pursuant to the Consolidated Finance Act (CFA) and not also within the meaning of the Corporate Governance Code exclusively in consideration of his long term in office. Said features were also evaluated by the Board of Directors during the meeting of 13 July 2016.

<sup>6</sup> Said features were also evaluated by the Board of Directors during the meeting of 24 April 2015.

## Nominations and Remuneration Committee work schedule and significant events concerning the Remuneration Policy



\* Executive or entrusted with special powers

\*\* Relating, inter alia, to ISS and Glass Lewis

### 3. Structure of the 2017 Remuneration Policy

The 2017 Policy sets general guidelines for determining the remuneration of Board of Directors members and Executives with strategic responsibilities, in the course of their business, with a view to attracting, retaining and motivating highly qualified managers and aligning their interests to the pursuance of the priority objective of creating sustainable value for Shareholders over a medium/long-term horizon.

In the 2015-2018 Business Plan, the Company defined its policy for managing the risk associated with the targets given, whose achievement is linked to the portion of incentive comprising the 2015-2017 LTI System, which is an integral and essential part of the 2017 Policy.

Where, in exceptional cases, the Board of Directors considers it necessary to deviate from the Policy previously approved and subjected to the vote of the shareholders' meeting, any decisions on the matter will be fully submitted to the Procedure for Related Party Transactions and information on such decisions will be disclosed to the market, pursuant to regulations and the said Procedure.

The 2017 Policy is structured differently according to whether the remuneration in question is intended for Board Members or Executives with strategic responsibilities.

#### 3.1 Board of Directors

##### 3.1.1 Fees

The Shareholders' Meeting is called upon annually, on a proposal from the Shareholders, to pass resolution on the assignment of fixed annual compensation for all members of the Board of Directors.

The Shareholders' Meeting is also called upon annually, on a proposal from the Shareholders, to pass resolution on the assignment of additional fixed annual compensation for independent directors called upon to sit on the NRC or the CRC.



The Board of Directors recommends that these fees be consistent with the professional commitment required by the office, as well as with the related responsibilities.

The Board of Directors also recommends that the fee proposals be presented by the Shareholders (where appropriate, also pursuant to Art. 126-bis of the Consolidated Finance Act - CFA) in such a way as to allow disclosure to the public sufficiently in advance with respect to the Shareholders' Meeting called upon to approve them.

In this connection, it should be mentioned that starting from 2013 the main shareholder has submitted proposals in line with the above recommendations, which were therefore communicated to the public suitably in advance of the Shareholders' Meeting called upon to approve them.

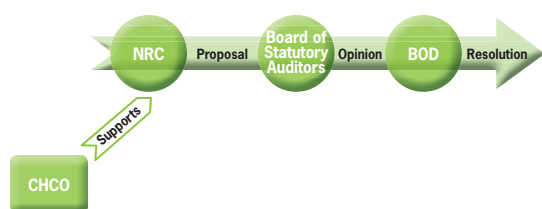
### 3.1.2 Remuneration

The remuneration paid to Executive Directors or Directors holding specific offices shall be suitable to attracting, retaining and motivating highly qualified individuals and aims at assigning a value to their skills, in line with the contribution required by the role.

#### Fixed component

The Board of Directors, upon a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, approves the allocation of fixed annual remuneration to Executive Directors or Directors holding specific offices.

The Board of Directors, again on a proposal from the NRC, with the support of the CHCO and having consulted the Board of Statutory Auditors, may assign fixed annual remuneration to the Directors called upon to sit on the Strategic Committee, where these are not employees of the Group and do not hold offices on the Board of Directors. Their remuneration is thus not linked to the Company's business performance.



The Board of Directors may, in the Company's interest, provide for the fixed component to be established still using the same criteria but on a three-year basis.

The amount of the annual fixed remuneration is measured proportional to the commitment required of each beneficiary for their respective offices, and is defined (based on the opinion of specialised consulting firms) through market benchmarking with listed companies. The comparison is made considering, within the ambit of the reference stock market, firms that are similar in terms of their type, size and complexity and by comparing individual roles.

#### Variable component

The Board of Directors, on a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, approves the allocation of variable remuneration to the Chief Executive Officer in the form of a monetary incentive linked to the achievement of specific performance targets correlated to the creation of sustainable value over the medium/long-term period, indicated in advance and determined based on the principles of the 2015-2017 LTI System.

The beneficiaries do not include Executive Directors whose interests are deemed to be intrinsically aligned with the pursuit of the priority objective of creating value for all Shareholders. As at the approval date of this Report, the individuals in question are the Chairman and the Executive Deputy Chairman.

The target value bonus is determined taking account of external salary benchmarks (relating to the long-term variable component of the salary) and the forecast value creation.

#### 2015-2017 LTI System

The aim of the 2015-2017 LTI System is to encourage maximum alignment, in terms of objectives, between the interests of the related beneficiaries and pursuit of the priority goal of creating sustainable value for Shareholders over a medium/long-term horizon.

The performance indices concurrently applied for each plan beneficiary are the Economic Value Added - meaning the cumulative  $\Delta$  EVA of the Group - and the absolute Total Shareholder Return.

- the **Economic Value Added** is a performance target that represents the "residual" economic value after all production factors have been remunerated, including



the cost of capital employed. Thus by expressing income net of the cost of capital, the EVA considers the equity and financial components alongside the income component. The  $\Delta$  EVA represents the improvement with respect to the target, over the reference period, as regards the creation of value. From a methodological point of view, the cumulative  $\Delta$ EVA is calculated as the sum of  $\Delta$  EVAs pertaining to the year 2014:  $(EVA_{2015} - EVA_{2014}) + (EVA_{2016} - EVA_{2014}) + (EVA_{2017} - EVA_{2014})$

- the **Total Shareholder Return** is a performance target linked to the performance of ERG's share in the reference three-year period and the amount of dividends for share paid in the same period. The opening reference price is the daily average of prices over a six-month period prior to 16 December 2015, the date of presentation of the 2015-2018 Business Plan to the market. The closing reference price is the daily average of prices over a three-month period prior to 15 February 2018 (15 November 2017 – 15 February 2018).

The performance indices are differentiated based on the role covered by the beneficiary within the ERG Group and in relation to the scenario of the 2015-2018<sup>7</sup> Business Plan approved and disclosed to the financial community.

Objective	Weight	Level of achievement of Performance Indicator	Incentive Paid
<b><math>\Delta</math> EVA</b>	60%	= Threshold Indicator	50% Target value
		$\geq$ Outstanding Indicator	130% Target value
<b>TSR</b>	40%	= Threshold Indicator	50% Target value
		$\geq$ Outstanding Indicator	150% Target value

The incentive strategy, namely the algorithm that links the EVA and TSR Performance to the bonus accrued, is as follows:

- below the Threshold Indicator, the bonus accrued is null;

- equivalent to the Threshold Indicator, the bonus accrued is equal to 50% of the Target Bonus (Threshold Bonus);
- equivalent to the Target Indicator, the bonus accrued is equal to the Target Bonus;
- for performance scenarios included between the Threshold and Target, the bonus accrued varies linearly;
- equivalent to the Outstanding Indicator, the bonus accrued is equal to 130% of the Target Bonus (Outstanding Bonus) for the component linked to EVA, while it is equal to 150% of the Target Bonus for the component linked to TSR;
- for performance scenarios included between Target and Outstanding Indicators, the bonus accrued varies linearly.

For each individual objective, the compensation recognised, in the case of **overshooting** of the corresponding **outstanding indicator** will not exceed a **predetermined cap**.

For each individual objective, in the case of **failure to achieve** the corresponding **threshold indicator**, **no compensation** will be recognised.

The entire compensation, where accrued, will be fully **paid at the end of the 2015-2017 LTI System**



The System also envisages the following:

- clawback clause**, namely, the Company has the right to exercise the option to request the partial or total return of the LTI compensation paid (or to withhold deferred amounts), within 3 years of its accrual, where the incentive is found to have been determined based on data that was subsequently deemed clearly incorrect;
- clauses** that govern the consequences of the termination of the mandate while the LTI System is in force<sup>8</sup>.

<sup>7</sup> For the related reference period.

<sup>8</sup> Details are provided in the information document available to the public at the Company's registered office in Via De Marini 1, Genoa, on the Company's website ([www.erg.eu](http://www.erg.eu)), in the section "Governance/Remuneration Reports", at Borsa Italiana S.p.A. and on the authorised storage platform eMarket Storage ([www.emarketstorage.com](http://www.emarketstorage.com)).

### 3.1.2 Balancing remuneration

The balancing of fixed and variable remuneration components aims to align the interests of the related beneficiaries with the Company's medium/long-term strategic objectives and the sustainable creation of value for Shareholders in compliance with the ERG Group risk management policy.

The weight of the fixed component of remuneration of the Chief Executive Officer, on an annual basis, corresponds on average to 60% of his overall target remuneration. The weight of the variable component of the Chief Executive Officer's remuneration, on a three-year basis, considering its annualised amount, is equal to 40%<sup>9</sup> of his total target remuneration.

The fixed component of remuneration is sufficient to remunerate the services of the Chief Executive Officer in cases where the variable component is not paid owing to failure to achieve the performance targets.



### 3.1.3 Pay for Performance

In the last few years, the ERG Group has been able to radically modify its business portfolio anticipating long-term energy scenarios and completed its transformation from industrial operator active in the refining sector, to leading independent producer of electricity predominantly from renewable resources.

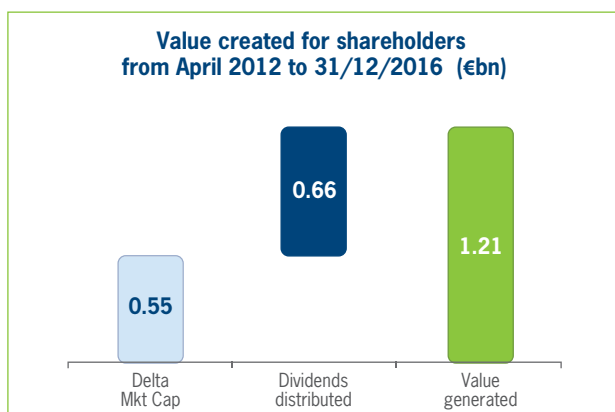
It should be mentioned that the transformation process, which began in 2008 with the sale of 49% of the ISAB refinery in Sicily, and the Group's gradual repositioning in more profitable activities with less exposure to market

volatility, has resulted in a notable creation of value for the Company and Shareholders and was made possible by the completion of the following extraordinary operations:

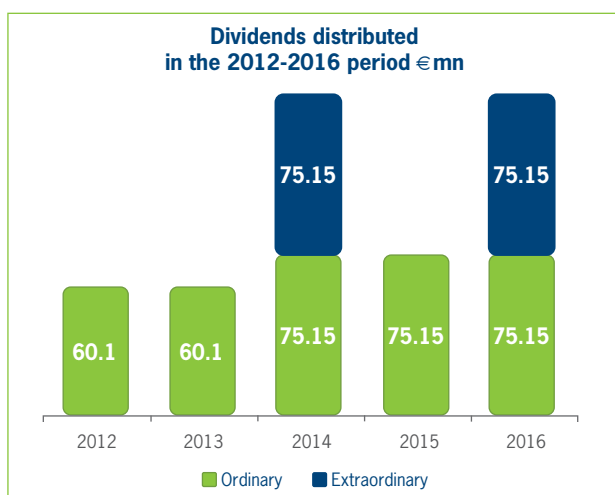
- **Progressive exit from refining:** this commenced in 2008 and was completed in 2013, with the sale of the remaining 20% stake.
- **Acquisition of IP Maestrale Investments:** in February 2013, ERG Renew acquired an 80% equity interest in IP Maestrale Investments Ltd, thereby increasing its installed power by 636 MW, of which 550 MW in Italy and 86 MW in Germany, and, consequently, becoming the leading wind power operator in Italy and among the top ten in Europe. ERG Renew thus reached a suitable industrial size and financial level to pursue autonomously its growth process.
- **Sale of the ISAB Energy IGCC plant:** in June 2014, ERG sold to ISAB (LUKOIL) the ISAB Energy and ISAB Energy Services business units, mainly comprising the IGCC generation plant. The operation, in line with the definitive exit from refining, is an additional fundamental step forward in the strategy to reposition the asset portfolio, at the same time strengthening the Group's capital structure to support future development plans.
- **Acquisition of E.ON Produzione's entire hydroelectric business:** in November 2015, ERG entered the hydroelectric sector with notable dimensions through the acquisition of an integrated hub of power plants located in the regions of Umbria, Marche and Lazio, with an overall capacity of 527 MW. This acquisition, of paramount strategic importance for the Group, offered the opportunity to diversify the production sources, by assuming a significant prominence in the Italian renewables panorama and procuring new high quality assets for the ERG Group.

During the period between April 2012 and December 2016, the trend in price of the shares and the dividend distribution policy ensured outstanding value creation for Shareholders, with a TSR (Total shareholders return) equal to 123% thanks to the growth path undertaken by the group and the extraordinary transactions that made it possible.

<sup>9</sup> This refers to the target value of the bonus.



During the period 2012-2015, the Company remunerated Shareholders with dividends totalling €495.9 million.



In order to ensure an increasing alignment between the interests of Shareholders and Management, in full compliance with the pay for performance principles, the ERG Group has decided to use also **non-recurring remuneration**.

In particular, the Board of Directors, upon a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, in the event of extraordinary transactions that:

- imply a significant transformation of the Group's long-standing assets
- generate strong value creation for the Company and Shareholders over the long term;
- entail, for management involved in the transactions, extraordinary work, on top of objectives considered in the systematised incentive plans;

may pass a resolution for the payment of non-recurring remunerations to the Executive Directors who participated in the transaction.

The amount of said remuneration is proportional to:

- the economic benefit and strategic weight of the transaction in question
- the contribution effectively given by each individual Director.

The non-recurring remunerations may provide for **deferral mechanisms** for retention purposes, based on which disbursement is conditional upon the continued existence, at the scheduled disbursement dates, of a collaboration relationship with ERG or with one of the Group companies, subject to dismissal/revocation for just cause, in keeping with the provisions set forth by the LTI System. They can also provide for a mechanism that (i) gives to the NRC, with the support of the CHCO, the verification of the existence of the conditions that have originally resulted in them being awarded and (ii) asks the Board of Directors for a resolution on the resulting payment.

### 3.1.4 Non-monetary benefits

The Shareholders' Meeting may decide, on a proposal from the Shareholders, that all members of the Board of Directors are entitled to receive certain non-monetary benefits (health and life insurance policies) the amount of which is withheld from the fixed annual compensation also approved by the Shareholders' Meeting.

The Board of Directors, upon a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, may resolve to assign benefits such as cars and living accommodation to Executive Directors or Directors holding specific offices, which are not withheld from the fixed annual compensation or remuneration.

### 3.1.5 Indemnity for early termination or non-renewal of office

The Board of Directors, upon a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, may resolve to assign<sup>10</sup> to the Chief Executive Officer, as a non-employee of the Company, an indemnity in the event of early termination or non-renewal of his office subject to the following conditions:

<sup>10</sup> See paragraph 4.2.2 under the item "Termination indemnity".

- the amount of said indemnity usually and save for exceptional cases, may not exceed the total amount of related fixed remuneration paid to the same under the relationship over a period of 24 months
- the indemnity must be determined in advance along with the overall remuneration
- the indemnity must not be paid in cases where termination of the relationship is due to the achievement of objectively inadequate results, subject to extraordinary events not attributable to the actions of the CEO
- the related resolution must be adopted in accordance with the medium/long-term strategy, values and interests of the ERG Group.

### 3.1.6 Termination indemnity

The Board of Directors, upon a proposal from the NRC, with the support of the CHCO, having consulted the Board of Statutory Auditors, may resolve to assign a termination indemnity to the Chief Executive Officer, as a non-employee of the Company, subject to the following conditions<sup>11</sup>:

- the amount of the indemnity, as a rule and save for exceptional cases, may not exceed the sum corresponding to 35% of the related total fixed remuneration paid to the same over his term of office;
- the payment must be determined in advance along with the overall remuneration
- the indemnity may not be paid in cases where, at the time of termination of office, objectively inadequate results have been achieved;
- the related resolution must be adopted in accordance with the medium/long-term strategy, values and interests of the ERG Group.

## 3.2 Executives with strategic responsibilities

### 3.2.1 Remuneration

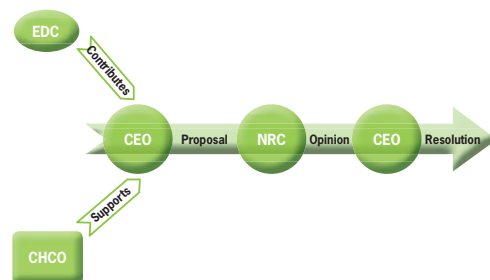
The remuneration paid to Executives with strategic responsibilities shall be suitable for attracting, retaining and motivating highly qualified individuals and is intended to assign a value to their skills, in keeping with the contribution required by their role, as well as to align their interests with the priority objective of creating sustainable value for Shareholders over the medium/long-term horizon.

<sup>11</sup> See paragraph 4.2.2 under the item "Termination indemnity".

The remuneration is broken down into two components, a fixed and a variable component; the variable remuneration is, in turn, broken down into two components, in the form of a monetary incentive linked to the achievement of specific performance targets, indicated and determined in advance, correlated to the creation of value in the short-term based on the rules of the MBO System and in the medium/long-term according to the principles of the 2015-2017 LTI System.

The following parties are involved in defining the overall remuneration of Executives with strategic responsibilities (as previously indicated in Chapter 2.):

- The Chief Executive Officer, jointly with the Executive Deputy Chairman and with the support of the CHCO, having consulted the NRC, determines the remuneration to be assigned to Executives with strategic responsibilities<sup>12</sup>;



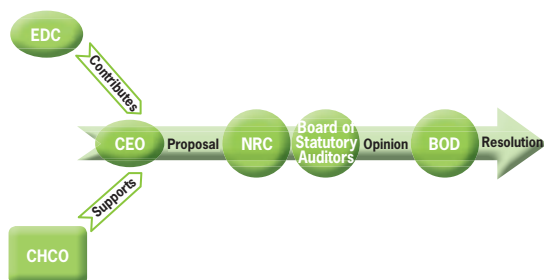
- The Board of Directors, based on a proposal from the Director in charge of the Internal Control and Risk Management System and subject to the favourable opinion of the CRC<sup>13</sup> and the support of the CHCO, having consulted the Board of Statutory Auditors, determines the remuneration of the Chief Audit Officer;



<sup>12</sup> Subject to the provisions set forth below concerning the Chief Audit Officer and the Manager Responsible for preparing the Company's financial reports.

<sup>13</sup> This being the body set up pursuant to the Corporate Governance Code to monitor the independence, adequacy, effectiveness and efficiency of the internal audit function.

- The Board of Directors, on a proposal from the Chief Executive Officer, jointly with the Executive Deputy Chairman and supported by the CHCO, having consulted the NRC and the Board of Statutory Auditors, determines the remuneration of the Manager Responsible for preparing the company's financial reports.



### Fixed component

The amount of the fixed remuneration is measured proportional to the commitment required of each beneficiary for their respective offices, and is defined (based on the opinion of specialised consulting firms) through market benchmarking with listed companies. The comparison is made considering, within the ambit of the reference stock market, firms that are similar in terms of their type, size and complexity and by comparing individual roles.

### Short-term variable component

The short-term variable component concerns the achievement of predetermined economic/financial and strategic targets and is governed by the MBO System. The variable component assigned to the Chief Audit Officer is linked to targets not correlated to economic performance indicators and is parametrised on the implementation of the annual audit plan.

The target value bonus is determined taking account of external salary benchmarks.

### Main characteristics of the MBO System

The MBO System is designed to encourage participants to achieve annual objectives.

The system provides for participants to be assigned performance targets structured as follows:

- one Group target, identical for all participants, with a weight corresponding to 30% of the incentive target amount and measured using the indicator EBT

("Consolidated pre-tax IAS result at adjusted replacement cost")

- additional individual targets (maximum of 3) associated with the role held, with a weight corresponding to 70% of the incentive target amount and measured according to quantitative indicators linked to economic/financial (EBITDA, PFN, Opex, ...) and/or project parameters.

Associated with each target is a weight and a relative share of the overall monetary incentive.

Type	Weight	Definition	Performance Indicator Attainment Level	Incentive Paid
Company target	30%	EBT (consolidated pre-tax IAS result at adjusted replacement cost) <sup>14</sup>	= Threshold Indicator	50% target value
			≥ Outstanding Indicator	150% target value
Individual target	70%	Divided in: - Business - Development - Organisation	= Threshold Indicator	80% target value
			≥ Outstanding Indicator	120% target value

Consistently with the high level of attention always and constantly paid by the Group to workplace safety a **Sustainability clause** was associated to the MBO system, according to which the bonus referred to the company target will not be paid, for the reference year, regardless of the company performance recorded, to the participants in the MBO system in the case of a fatal accident, or an accident that causes a degree of permanent disability greater or equal to 46% to an employee of the Group.

The compensation recognised in the event of overshooting the outstanding indicator cannot exceed a **predetermined cap**, namely 150% of the target value for the company target and 120% of the target value for individual targets.

In the case of **failure to achieve the threshold indicator**, namely 80% of the target value for individual targets and 50% of the target value for the company target, **no compensation is paid**.

<sup>14</sup> Excluding proceeds (charges) deriving from the investment in TotalErg S.p.A.

The system provides for the Company to have the right to exercise the **clawback clause**, namely the option to request the partial or total return of the MBO compensation paid (or to withhold deferred amounts), within 3 years from its accrual, where the incentive is found to have been determined based on data that was subsequently deemed clearly incorrect.

#### Medium/long-term Variable Component

The medium/long-term variable component is structured in such a way as to align the interests of the beneficiaries with pursuit of the priority goal of creating sustainable value for Shareholders over the medium/long-term horizon. The Chief Audit Officer does not participate in the 2015-2017 LTI System.

The target value bonus is determined taking account of external salary benchmarks (relating to the long-term variable component of the salary) and the forecast value creation.

#### 2015-2017 LTI System

The aim of the 2015-2017 LTI System is to encourage maximum alignment, in terms of objectives, between the interests of the related beneficiaries and pursuit of the priority goal of creating sustainable value for Shareholders over a medium/long-term horizon.

The performance targets simultaneously applied for each plan beneficiary are the Economic Value Added – intended as the Group's cumulative  $\Delta$  EVA for the so-called corporate resources and the cumulative  $\Delta$  EVA pertaining to the related Business Unit for the so-called business resources - and the absolute Total Shareholder Return.

- the **Economic Value Added** is a performance target that represents the “residual” economic value after all production factors have been remunerated, including the cost of capital employed. Thus by expressing income net of the cost of capital, the EVA considers the equity and financial components alongside the income component. The  $\Delta$  EVA represents the improvement with respect to the target, over the reference period, as regards the creation of value. From a methodological point of view, the cumulative  $\Delta$ EVA is calculated as the sum of  $\Delta$  EVAs pertaining to the year 2014:  $(EVA_{2015} - EVA_{2014}) + (EVA_{2016} - EVA_{2014}) + (EVA_{2017} - EVA_{2014})$ .

- Total Shareholder Return** is a performance target linked to the performance of ERG's share in the reference three-year period and the amount of dividends for share paid in the same period. The opening reference price is the daily average of prices over a six-month period prior to 16 December 2015, the date of presentation of the 2015-2018 Business Plan to the market. The closing reference price is the daily average of prices over a three-month period prior to 15 February 2018 (15 November 2017 – 15 February 2018).

The performance indices are differentiated based on the role covered by the beneficiary within the ERG Group and in relation to the scenario of the 2015-2018<sup>15</sup> Business Plan approved and disclosed to the financial community.

Type	Corporate Resources Weight	Business Resources Weight	Performance Indicator Attainment Level	Incentive Paid
<b><math>\Delta</math> EVA</b>	60%	80%	= Threshold Indicator	50% target value
			$\geq$ Outstanding Indicator	130% target value
<b>TSR</b>	40%	20%	= Threshold Indicator	50% target value
			$\geq$ Outstanding Indicator	150% target value

The incentive strategy, namely the algorithm that links the EVA and TSR Performance to the bonus accrued, is as follows:

- below the Threshold indicator, the bonus accrued is null;
- equivalent to the Threshold Indicator, the bonus accrued is equal to 50% of the Target Bonus (Threshold Bonus);
- equivalent to the Target Indicator, the bonus accrued is equal to the Target Bonus;
- for performance scenarios included between the Threshold and Target, the bonus accrued varies linearly;
- equivalent to the Outstanding Indicator, the bonus

15 For the related reference period.



accrued is equal to 130% of the Target Bonus (Outstanding Bonus) for the component linked to EVA, while it is equal to 150% of the Target Bonus for the component linked to TSR;

- for performance scenarios included between Target and Outstanding Indicators, the bonus accrued varies linearly.

For each individual objective, the compensation recognised, in the case of overshooting of the outstanding indicator, will not exceed a predetermined cap.

For each individual objective, in the case of failure to achieve the related threshold indicator, no compensation is recognised.

The entire compensation, where accrued, will be fully paid at the end of the 2015-2017 LTI System.



The System also envisages the following:

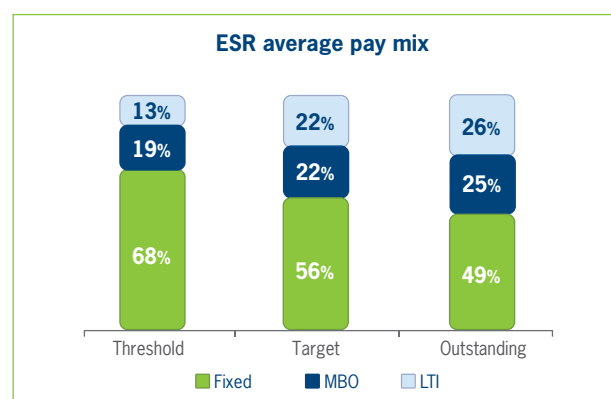
- clawback clause, namely, the Company has the right to exercise the option to request the partial or total return of the LTI compensation paid (or to withhold deferred amounts), within 3 years of its accrual, where the incentive is found to have been determined based on data that was subsequently deemed clearly incorrect.
- clauses that govern the consequences of termination of employment while the LTI System is in force<sup>16</sup>.

### 3.2.2 Balancing remuneration

The balancing of fixed and variable remuneration components aims to align the interests of the related beneficiaries with the Company's medium/long-term strategic objectives and the sustainable creation of value for Shareholders in compliance with the ERG Group risk management policy.

The weight of the fixed component of remuneration for

each Executive with strategic responsibilities, on an annual basis, corresponds on average to 56% of his overall target remuneration. The weight of the annual variable component (MBO) of remuneration corresponds on average to 22%<sup>17</sup> of the related total target remuneration, while the medium/long-term variable component (LTI), considering its annualised amount, has an average weight of 22%<sup>18</sup> of the related total target remuneration.



The fixed component is sufficient to remunerate the services of the Executive with strategic responsibilities in cases where the variable component is not paid owing to failure to achieve the performance targets.

### 3.2.3 Pay for Performance

In order to ensure an increasing alignment between the interests of Shareholders and Management, in full compliance with the pay for performance principles, the ERG Group has decided to use also non-recurring remuneration. In particular, the Chief Executive Officer, jointly with the Executive Deputy Chairman and with the support of the CHCO, having consulted the NRC, in the event of extraordinary transactions that:

- imply a significant transformation of the Group's long-standing assets;
- generate strong value creation for the Company and Shareholders over the long term;
- entail, for management involved in the transactions, extraordinary work, on top of objectives considered in the systematised incentive plans;

<sup>16</sup> Details are provided in the information document available to the public at the Company's registered office in Via De Marini 1, Genoa, on the Company's website ([www.erg.eu](http://www.erg.eu)) in the section, "Governance/Remuneration Reports", at Borsa Italiana S.p.A. and on the authorised storage platform eMarket Storage ([www.emarketstorage.com](http://www.emarketstorage.com)).

<sup>17</sup> This refers to the target value of the bonus.

<sup>18</sup> This refers to the target value of the bonus.

may resolve the recognition of non-recurring remuneration to the Executives with strategic responsibilities who participated in the transaction.

The amount of said remuneration is proportional to:

- the economic benefit and strategic weight of the transaction in question
- the contribution effectively given by each individual Executive with strategic responsibilities.

The non-recurring remunerations may provide for **deferral mechanisms**, based on which disbursement is conditional upon the continued existence, at the scheduled disbursement dates, of a collaboration relationship with ERG or with one of the Group companies, subject to dismissal/revocation for just cause, in keeping with the provisions set forth by the LTI System. They can also provide for a mechanism that (i) gives to the NRC, with the support of the CHCO, the verification of the existence of the conditions that have originally resulted in them being awarded and (ii) asks the Chief Executive Officer, jointly with the Executive Deputy Chairman, for a resolution on the resulting payment.

### 3.2.4 Non-monetary benefits

The Chief Executive Officer, jointly with the Executive Deputy Chairman and with the support of the CHCO, having consulted the NRC, may decide to assign benefits such as insurance policies (health and life insurance), pension benefits, cars and living accommodation to Executives with strategic responsibilities, which are not withheld from remuneration<sup>19</sup>.

The Board of Directors, on a proposal from the Director in charge of the Internal Control and Risk Management System, having obtained the favourable opinion of the CRC and the support of the CHCO, and having consulted the Board of Statutory Auditors, may decide to assign benefits such as insurance policies (health and life insurance), pension benefits, cars and living accommodation to the Chief Audit Officer, that are not withheld from remuneration.

The Board of Directors, on a proposal from the Chief

Executive Officer, jointly with the Executive Deputy Chairman, with the support of the CHCO, having consulted the NRC and the Board of Statutory Auditors, may decide to assign benefits such as insurance policies (health and life insurance), pension benefits, cars and living accommodation to the Manager Responsible for preparing the Company's financial reports, which are not withheld from remuneration.

### 3.2.5 Resignation from office or termination of the employment relationship

The terms and conditions of the national collective agreement for industrial managers of companies producing goods and services shall apply to Executives with strategic responsibilities, due to their status as employees, in the event that employment is terminated for justified motive or just cause. In accordance with the provisions of Italian Law – Article 2120 of the Italian Civil Code – Executives with strategic responsibilities who for whatsoever reason tender their resignation, receive termination indemnity, which on average is equal to 7% of their gross annual remuneration. The payment of Termination indemnity is not subject to the achievement of any minimum performance condition.

### 3.3 Incentive plans based on financial instruments

The 2015-2017 LTI System (monetary incentive system), with the adoption of the TSR, introduced a performance target linked to the performance of ERG's share, meaning that the same is attracted by the provisions set forth by Art. 114-bis of the Consolidated Finance Act (CFA) for plans that envisage assignment of financial instruments, insofar as applicable.

The calculation of the TSR, presupposes determination of the share's opening price on the reference stock exchange and reference closing price. The opening reference price is the daily average of prices over a six-month period prior to 16 December 2015, the date of presentation of the 2015-2018 Business Plan to the market. The closing reference price is the daily average of prices over a three-month period prior to 15 February 2018 (15 November 2017 – 15 February 2018).

<sup>19</sup> Subject to the provisions set forth below concerning the Chief Audit Officer and the Manager Responsible for preparing the Company's financial reports.



## GLOSSARY

In addition to the definitions set out in other articles, capitalised terms and expressions used in the Report have the meaning assigned to them herein. Said meaning shall be valid for both the singular and the plural:

**CEO:** Chief Executive Officer

**DCICRMS:** Director in Charge of the Internal Control and Risk Management System

**Shareholders' Meeting:** Shareholders' Meeting of ERG S.p.A.

**CAO:** Chief Audit Officer

**CRC:** Control and Risk Committee; a board committee comprising 3 non-executive directors, mostly independent, appointed by the Board of Directors in the meeting of 24 April 2015

**CHCO:** Chief Human Capital Officer

**Committee** or **NRC:** Nominations and Remuneration Committee; a board committee comprising 3 non-executive directors, mostly independent, appointed by the Board of Directors in the meeting of 24 April 2015

**Corporate Governance Code:** the current version (published in July 2015) of the Italian Corporate Governance Code for listed companies as promoted by Borsa Italiana S.p.A., which the Board of Directors resolved to comply with on 15 December 2015

**Board of Statutory Auditors:** the Board of Statutory Auditors of ERG S.p.A.

**Board of Directors** or **BD:** the Board of Directors of ERG S.p.A.

**Executives with strategic responsibilities** or **ESR:** parties that hold the functions/ offices indicated in Annex 1 to the ERG Group Procedure for Related Party Transactions currently in force (except for the members of the ERG S.p.A. Board of Directors and Board of Statutory Auditors) available on the Company's website ([www.erg.eu](http://www.erg.eu)) in the section "Corporate governance/Governance documents"

**ERG** or the **Company:** ERG S.p.A.

**EBT:** Consolidated IAS pre-tax result at adjusted replacement cost net of the proceeds (charges) deriving from equity investment in TotalErg.

**EVA:** Economic Value Added, namely the "residual" economic value after all production factors have been remunerated, including the cost of capital employed

**Policy** or **Remuneration Policy:** the Policy for the remuneration of members of the Board of Directors and Executives with strategic responsibilities

**2016 Remuneration Policy** or **2016 Policy:** ERG's Policy for the remuneration of members of the Board of Directors and Executives with strategic responsibilities for the year 2016

**2017 Remuneration Policy** or **2017 Policy:** ERG's Policy for the remuneration of members of the Board of Directors and Executives with strategic responsibilities for the year 2017

**Procedure:** Procedure for Related Party Transactions, as adopted by the Board of Directors with resolution dated 11 November 2010, subject to the favourable opinion of the Control and Risk Committee and with the approval of the Board of Statutory Auditors, most recently updated on 1 January 2017

**IR:** Regulations implementing Legislative Decree no. 58 dated 24 February 1998, as amended (Issuers' Regulations)

**Report** or **Remuneration Report:** Report on remuneration of the members of the Board of Directors and Executives with strategic responsibilities, approved by the Board of Directors on 9 March 2017

**2012-2014 LTI System:** Medium/Long-Term Monetary Incentive System, referred to the period 2012-2014

**2015-2017 LTI System** or **LTI System:** Medium/Long-Term Monetary Incentive System referred to the period 2015-2017

**MBO System:** Short-Term Monetary Incentive System

**TSR:** Total Shareholder Return, namely the overall return on investment for shareholders, which is calculated by summing the increase in the share's price over a specific time interval with the effect of dividends for share paid during the same period

**Consolidated Finance Act (CFA):** Legislative Decree No. 58 dated 24 February 1998, as amended (Consolidated Finance Act)

**EDC:** Executive Deputy Chairman

**ERG S.p.A.**

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