2018 UK AGM Season Preview

Building from Theresa May's pre-election platform, and the public consultation on the Corporate Governance Reform Green Paper published by BEIS, in August 2017 the UK government announced a suite of reforms intended to "enhance the public's trust in business". UK Business Secretary Greg Clark set out the British government's plans for corporate governance reform in an attempt to put downward pressure on boardroom pay and enhance the transparency of big business to shareholders, employees and the public. The main points refer to BEIS legislation requiring annual publication, and justification of, the pay ratio between CEOs and the average UK worker and the integration of an explanation of how directors take employees' and shareholders' interests into account.

Other non-legally binding measures will see all listed companies who receive more that 20% shareholder opposition to executive pay packages having their names published on a new public register. The Investment Association has created and will maintain this register where it records against votes above 20%, issuer response to such dissent and any other relevant information surrounding the proposals themselves and/or the circumstances leading to the dissent.

Parker Review

In Autumn 2017, the Parker Review Committee's "A report into the Ethnic Diversity of UK Boards" was published following a consultation process. The report contains the committee's final musings on ethnic diversity on UK boards, specifically those listed on the FTSE 100 and 250. Though the review acknowledges the "overwhelmingly positive" feedback from stakeholders during the open consultation period, its initial recommendations remain unchanged.

The review recommends that at least one director of colour should be appointed to each FTSE 100 board by 2021 (by 2024 for FTSE 250 companies), that board chairs and existing directors should identify, mentor and/or sponsor people of colour within their own organisation to ensure their readiness to assume senior roles, and that companies should disclose in their annual report their efforts to enhance ethnic diversity.

The recommendations are initially being posited on a "comply or explain" basis, in line with UK Code norms; however, the review is suggestive of a potentially stricter stance if there is "insufficient progress towards the goals" outlined above. Early disclosers, such as GSK, have already adjusted their

diversity policy to reflect Parker recommendations and we expect other companies to follow suit.

Revised UK Corporate Governance Code

The Financial Reporting Council has published an amended UK Corporate Governance Code which is currently out for consultation. The proposed changes reflect recommendations from the Parker and Hampton-Alexander reviews, as well as certain reforms proposed by the UK government.
The proposed new code, which FRC chair Win Bischoff describes as "shorter and sharper and fit for purpose', continues to operate on a 'comply or explain' basis and is divided into five sections:

- Leadership and purpose;
- Division of responsibilities;
- Composition, succession and evaluation;
- Audit, risk and internal control; and
- Remuneration.

In line with earlier calls for employee representation made by Prime Minister Theresa May in 2016, the revised code suggests that companies should either assign a non-executive director to represent employees, create an employee advisory council, or nominate a director from the workforce. Further, in an effort to encourage transparency and responsiveness to AGM voting, companies will need to explain what action has been taken to consult with shareholders when more than 20% of votes have been cast against the board's recommendation.
Companies outside of the FTSE 350 have more to consider. Exemptions for smaller companies previously included in the Code in relation to independence (B.1.2), board evaluation (B.6.2), annual re-election (B.7.1), and the composition of audit and remuneration committees (C.3.1 and D.2.1) have been removed.

Diversity in Focus - Board Skills Matrices

The authors of the revised UK Code have also taken into account the views of the Hampton-Alexander Review and Parker Review on diversity – challenging directors to not only consider the composition of the board, but also of management. More specifically, a provision has been added which requires the nomination committee to explain what actions they have taken to increase diversity in its executive pipeline, and requires that companies report specifically on the gender balance in the first layer of management below board level. All companies, not only those in the FTSE 350, will be encouraged to increase transparency in this area.

Board composition is a key focal point for shareholders when assessing the corporate governance of investee companies. While discussion of board composition often focuses on gender diversity, the increasingly circumspect investing environment means the investor gaze is widening in order to better assess board diversity in the broadest and deepest sense, taking into account factors such as skills, strategy, experience and independence along with gender.

Some market leaders are already adapting to investor expectations in this regard. In their 2017 annual reports, Lloyds Banking Group and Unilever both use skills matrices to better communicate their board composition to investors. However, their approach is somewhat different. Lloyds provides a table with graphics displaying the gender, tenure, and age diversity of the board. They also include the skills required by the board, and how many non-executives have each skill. Unilever don't use graphics, but they do provide a director-by-director skills breakdown, and also include the nationality of each director and their committee membership – drawing a clear line between each non-executive's responsibilities and the skills and experience they possess that qualify them for those responsibilities.

Remuneration

After persistent concerns over high levels of executive remuneration at UK companies, the proposed BEIS legislation (referred to above) will require quoted companies to report annually in their remuneration report, the ratio of CEO pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year and how the ratio relates to pay conditions across the wider workforce. While certain issuers, BAE Systems being an example, pre-emptively published their CEO pay ratio in their 2017 Annual Report, all quoted companies will be required to disclose this information by June 2018 (applying to company reporting years commencing on or after that date). As such, it will likely be 2019 before we see widespread reporting of CEO pay ratios.

Similarly, in Proxy Season 2017, we saw most issuers express salary increases as relative to average increases across the group – we expect this trend to continue in 2018. We also expect that large unexplained deviations from average will not be well received by investors.

In terms of absolute quantum, investors are likely to make their feelings on excess known. We have already seen the influence of public perception at Persimmon plc. In December 2017. Nicholas Wrigley, the chair, and Jonathan Davie, senior independent director and chair of the remuneration

committee, resigned from the board following revelations that the company's executive leadership stood to make approximately £232 million from a controversial long-term incentive plan dating back to 2012 and subsequently, in February 2018, following previous public declarations that he would donate a portion of his £110 million payout in an attempt to appease investors, Persimmon announced that Jeff Fairburn's LTIP award would be reduced to £75 million. The reduction came following shareholders began publicly voicing concern and indicating a possible vote against the re-election of certain directors.