

## **2017 UK AGM SEASON PREVIEW**

As the 2017 AGM season gets underway, we give an overview of the key issues facing FTSE 350 issuers and their investors. This document accompanies our UK 2017 Proxy Season Preview Podcast (see Appendix 1).

### **A REFORM AGENDA**

On the back of Theresa May's election, the momentum for corporate governance reform in the UK has accelerated. Corporate governance has entered mainstream political debate, as evidenced by the recent public consultation on the Corporate Governance Reform Green Paper published by BEIS. Throughout 2016, the publication of a number of other policy statements and studies (see Appendix 2) have contributed to a vigorous debate on the direction of UK governance reform.

Executive remuneration, board diversity, culture and shareholder engagement have emerged as key areas of focus for 2017. Of those, remuneration and board diversity are likely to prove the most contentious topics at a large number of UK companies and merit further discussion.

### **REMUNERATION**

This year approximately two-thirds of the FTSE 350 will submit their remuneration policies for binding approval by shareholders. Such policy votes, which are only required to be held once every three years, are likely to be subjected to intense investor, media and political scrutiny.

#### ***Political Climate***

Although the FTSE is trading at roughly the same levels as 18 years ago, executive pay has more than trebled during that time. This trend has been mirrored by growing income inequality both within companies and across society more broadly, which many believe has eroded public confidence in business.

In fact, concern over income equality has grown so large that politicians, including Prime Minister Theresa May, have begun speaking about reigning in executive pay in a way that was previously taboo in the UK. However, given the primacy of the comply or explain approach in the UK, issuers and investors, rather than regulators, are expected to take the lead in restoring faith in big business and in contributing to public policy objectives.

#### ***Investor Expectations***

Given such concerns and expectations, remuneration committees once again find themselves at the frontline this AGM season, and it will often be their policies and practices against which a board's efficacy is judged. Given such a climate, many

investors feel obliged to exert pressure over remuneration in 2017, as they did most notably in 2012 and 2016.

In terms of actionable specifics, investor groups have raised concerns around quantum, alignment with long-term value, and the complexity of short- and long-term bonus plans. As such, investors will be expecting remuneration committees to show restraint when it comes to pay increases; to enhance shareholding requirements; to consider diversifying the metrics against which long-term incentives are measured; and to simplify incentive schemes that are perceived as being overly complex.

Some of the more forward-looking boards may also make meaningful attempts to disclose CEO pay ratios, in order to illustrate CEO pay as compared with that of a company's wider workforce. It's also apparent that a number of boards have sought to communicate to management that the use of downward discretion to reduce bonus payouts is a very real possibility going forward, particularly when formulaic outcomes are deemed unrepresentative of the shareholder experience.

### ***Rebellion at Imperial Brands***

The first remuneration-related shareholder rebellion of the season was triggered by concerns over a proposed pay increase for the CEO at Imperial Brands. Perhaps mindful of the current political climate, Imperial's remuneration committee decided to grant the proposed increase in performance-related equity awards under the Long-Term Incentive Plan, rather than, say, as an increase in salary. As a result, the CEO's maximum LTI opportunity was to increase from 350% to 450% of salary. In addition, the committee proposed the diversification of LTI metrics and the introduction of post-exit shareholding requirements.

However, the board was forced to withdraw its proposed policy in advance of the AGM on February 1st in order to avoid a public defeat on the matter. The lesson here is that any and all pay increases deemed to be excessive may face significant resistance, regardless of how those pay increases are delivered. As a general rule, we expect that any increase in executive pay that outpaces those for a firm's broader workforce will be assessed with enhanced scepticism by investors.

### **BOARD DIVERSITY**

Recent government-backed reviews have called for greater diversity at both board and senior management levels at FTSE 350 companies. Enhancing the diversity of boards so their compositions better reflect the demographics of employees, customers and other stakeholders is seen as crucial to companies' capacity to deliver on their wider social responsibilities by ensuring that a broader range of social perspectives, talent and expertise can influence decision-making.

### ***Gender Diversity***

The Hampton-Alexander Review has reiterated the call made by its predecessor, the Davies Review, for FTSE 350 boards to ensure that they comprise at least 33% female directors by 2020. However, this voluntary target has now been broadened to 33% female representation at the combined executive committee and direct report levels, albeit only at FTSE 100 companies for the time being. This focus on the executive pipeline is intended to address the slowdown in the rate of female appointments at board level.

Among the Hampton-Alexander Review's other recommendations is a call for institutional investors to formulate "a clear voting policy on gender balance". For its part, Glass Lewis will focus its efforts on scrutinising all-male boards that have failed to make progress on gender diversity, particularly where this correlates with a failure to disclose a coherent gender diversity policy.

### ***Ethnic Diversity***

Elsewhere, the Parker Review's inaugural report into the ethnic diversity of UK boards recommends that each FTSE 100 board should have at least one director of colour by 2021, and that each FTSE 250 board should have a director of colour by 2024.

Sir Parker's recommendations have been made in light of his review's conclusion that UK companies are failing to promote enough non-white employees to senior management positions – currently just 8% of FTSE directors are non-white as compared with 14% of the wider workforce. A consultation period is now open and final recommendations are expected to be published during 2017.

While the question of reporting on ethnic diversity remains an open one, we anticipate that the majority of FTSE 350 issuers will continue to disclose relatively non-committal gender diversity policies, promising only to consider diversity in its broadest sense when making appointments, rather than specifying hard targets.

## APPENDIX 1

The Proxy Season Preview Podcast accompanying this document may be found at <http://www.glasslewis.com/2017-uk-season-preview/>.

### *Show Notes*

- A reform agenda places corporate governance front and center. (1:00)
- Binding say on pay votes hold issuers to account, particularly on quantum. (3:40)
- Expectations for shareholder engagement ahead of pay changes. (7:35)
- Asset managers join the reform agenda. (8:48)
- The Hampton-Alexander Review raises the bar for board diversity. (9:43)
- What about the executive pipeline for women? (12:13)
- The Parker Review looks for 1 by 21. (13:23)
- Issuers focus on getting their culture right. (14:55)
- Is it even possible to measure and improve culture? Examples of meaningful change. (16:07)
- The new norm: engaging with stakeholders is a must. (18:38)
- Glass Lewis presents 2017 policy updates. (20:37)

## APPENDIX 2

Selected links from the Proxy Season Preview and Podcast.

*The following policy positions or studies regarding corporate governance in the UK were published in 2016.*

- Theresa May's speech to launch Conservative Party leadership campaign (July 11, 2016) <http://www.ukpol.co.uk/theresa-may-2016-speech-to-launch-leadership-campaign/>
- Executive Remuneration Working Group: Final Report (July 2016) <http://www.theinvestmentassociation.org/assets/files/press/2016/ERWG%20Final%20Report%20July%202016.pdf>
- FRC: Corporate Culture and the Role of Boards, Report of Observations (July 20, 2016) <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Report-o.pdf>
- Department for Business, Energy & Industrial Strategy: Corporate Governance Reform Green Paper (November 2016) [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/584013/corporate-governance-reform-green-paper.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf)
- Hampton-Alexander Review: FTSE Women Leaders (November 2016) [https://30percentclub.org/assets/uploads/UK/Third\\_Party\\_Reports/Hampton\\_Alexander\\_Review\\_Paper\\_Nov\\_2016.pdf](https://30percentclub.org/assets/uploads/UK/Third_Party_Reports/Hampton_Alexander_Review_Paper_Nov_2016.pdf)
- Corporate Governance Reform Green Paper (November 2016) [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/584013/corporate-governance-reform-green-paper.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf)
- The Parker Review Committee: A Report into the Ethnic Diversity of UK Boards [http://www.ey.com/Publication/vwLUAssets/A\\_Report\\_into\\_the\\_Ethnic\\_Diversity\\_of\\_UK\\_Boards/\\$FILE/Beyond%20One%20by%2021%20PDF%20Report.pdf](http://www.ey.com/Publication/vwLUAssets/A_Report_into_the_Ethnic_Diversity_of_UK_Boards/$FILE/Beyond%20One%20by%2021%20PDF%20Report.pdf)

*Further information on Glass Lewis.*

- Glass Lewis 2017 Policy Guidelines <http://www.glasslewis.com/guidelines/>
- Glass Lewis engagement policy <http://www.glasslewis.com/engagement-policy/>
- Meetyl engagement platform <https://meetyl.com/>