GLASS LEWIS

2019 Proxy Season Preview – UK

The most significant regulatory development for FTSE-listed companies in the past year has been the publication of the new UK Corporate Governance Code in July of 2018. The Code was initially scheduled to be published in June of 2018 but had to be delayed by a month as a result of the large number of responses received during the consultation process. The extent of the response, from such a wide variety of stakeholders, reflects the increasing interest in the governance of UK issuers, which has been stoked by high profile governance failure at companies such as Carillion.

The Code will become effective for issuers with reporting periods beginning on or after January 1, 2019. As such, it will be the 2020 AGM season before we see its full impact. However, having engaged with a large proportion of the FTSE 350, we know there will be a substantial number of early adopters this year.

Workforce Engagement

For early adopters, the Code provision providing issuers with guidelines on engaging their workforces will be of particular interest. Although implementation of the concept is still in its infancy in the UK, we are already seeing a diversity of approaches. The code itself suggests four options for issuers to engage with their workforce: assigning a specific non-executive director to represent employees; creating an employee advisory council; or nominating a board-level director from the wider workforce and, what we have come to call Option D, whereby if the board chooses an alternative approach, the Code recommends that this arrangement should be explained, with a discussion of why this alternative is considered effective.

Director Tenure

For non-executive directors, the 2018 Code includes a "comply or explain" provision suggesting that NEDs who have served longer than nine years should be considered non-independent, whereas previous iterations have stated that this is simply one factor to be considered in determining independence.

Interestingly, the provision relating to tenured chairs has somewhat firmer language. The Code states that chairs should not remain in post beyond nine years from the date of their first appointment to the board. This particular provision raised some eyebrows during the consultation process, particularly due to the relatively common practice of promoting a sitting non-executive to the role of chair – effectively reducing even further that individual's potential tenure as chair. However, as with all provisions of the code, an issuer does have the option to explain non-compliance – and given the FRC's overall emphasis on encouraging active engagement with the spirit of the code, we expect to see issuers utilising the "explain" option to justify retention of a tenured chair.

Board Diversity

In terms of gender diversity, the 2018 Code update advocates an increased focus on diversity at not only board level, but also at senior management level. We've included a section on precisely these issues in our Election of Directors analysis for FTSE350 companies for a number of years now, and have found that standards – and year-on-year progress – vary significantly.

We believe stakeholders should pay particular attention to so-called "one and done" boards: companies in the FTSE350 which have appointed a single female director but have made no further progress in recent years. We have always considered diversity holistically, mindful of organic succession planning, so we don't believe that board-level gender quotas are always appropriate. But as the 2020 deadline for the recommendations of the Hampton-Alexander Review approaches, we think that one-and-done boards should carefully consider how measurable diversity objectives give shareholders visibility on their strategy for improving diversity.

Executive Remuneration

We expect that concerns regarding quantum will be the primary source of dissent once again this year. In fact, one such revolt has already occurred at Plus500 where approximately 48% of shareholders opposed two resolutions relating to remuneration arrangements for the CEO and CFO.

Currently driving shareholder scrutiny of remuneration proposals are concerns regarding salary increases. In line with client expectations, we scrutinise all salary increases above those awarded to the broader workforce on average. Where such an increase has not been flagged in advance, nor a compelling rationale provided for its necessity, we have found it difficult to offer supportive recommendations, and this will continue to be the case in 2019.

Pension contributions were heavily scrutinised during 2018 and are likely to prove even more contentious this year given the Code's assertion that "pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce".

Adding to this focus, the Investment Association recently stated its expectation that new executive directors and directors changing roles be appointed on a pension contribution level in line with that available to the workforce. Further, the IA expects that contributions for current executives should be reduced over time to equal the rate received by the majority of the workforce; however, no compensation should be awarded for this change. As such, we will expect to see positive change in this regard at any meeting where a remuneration policy is up for renewal.

Board Responsiveness

Aligned with recent changes to the UK Code, and a renewed focus on culture and wider stakeholder engagement, the push for qualitative assessments of board responsiveness to perceived and demonstrated shareholder concern has recently accelerated.

The Investment Association's Public Register has recorded a 25% year-on-year increase in the number of general meeting proposals receiving significant shareholder opposition. It will come as no surprise that the majority of these have been remuneration proposals, but more interesting is the fact that such concerns are being escalated a year later in the form of votes against individual directors where a board's response to dissent has been deemed insufficient. For repeat offenders, to whom the IA have written, the pattern seems to be clear: A lack of response and/or engagement will result in directors receiving high against votes the following year.

SHOW NOTES

Glass Lewis presents a preview of the upcoming 2019 proxy season for the UK. Members of the Glass Lewis research team discuss key developments for the 2019 proxy season, including regulatory updates, executive remuneration, and board composition and diversity.

SPEAKERS

- Martin Mortell – Director of Research, UK & Europe
- Bernadette O'Donoghue – Senior Research Analyst
- Paul Völsch – Senior Research Analyst
- Cian Whelan – Research Analyst
- Eanna Kelly – Research Analyst

SHOW NOTES

- UK Corporate Governance Code Updates (00:38)
- Executive Remuneration (09:04)
- Board Responsiveness (14:35)

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