

**PENSIONS AND  
LIFETIME SAVINGS  
ASSOCIATION**

# **STEWARDSHIP AND VOTING GUIDELINES 2021**

**MARCH 2021**



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## INTRODUCTION

The PLSA's mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value of those savings and to build the confidence and understanding of savers.

We represent the defined benefit, defined contribution, master trust and local authority pension schemes that together provide a retirement income to 20 million savers in the UK and invest £1 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs and others who play an influential role in the investment, governance, administration and management of people's financial futures.

## ACKNOWLEDGEMENTS

The PLSA would like to thank all members of the Working Group that have contributed their time and expertise as part of the drafting of this guidance, as well as the members of the PLSA Stewardship Advisory Group, for their input.

The PLSA would also like to express its thanks to Claudia Chapman and Catherine Horton of the FRC, and to the PLSA Stewardship Advisory Group for their support and contributions to this guidance.

## EXECUTIVE SUMMARY

The growing expectations, both regulatory and societal, on pension schemes to demonstrate that they are responsible and active asset owners, makes it more important than ever that schemes act as good stewards.

Having previously undertaken a substantial review of our Voting Guidelines, the PLSA has this year focused on ensuring that the guidelines remain relevant and a fast moving, and increasingly complex, world.

For 2021 we have responded to the pandemic by confirming our positions on virtual AGMS, and stating the importance of executive pay reflecting the performance and challenges of the past year

We have also strengthened our guidance on what we expect from companies on reporting in line with the Taskforce of Climate Related Financial Disclosures – we think it is reasonable that investors increase their asks.

This guide is aimed at scheme investors, their investment service providers and companies interested in using our guidelines as a benchmark for their corporate reporting and investor relation work.

It covers:

- ▶ The policy framework for scheme stewardship. What the new regulations on shareholder engagement mean for scheme investors and how corporate governance and stewardship relate to each other;
- ▶ Why good scheme stewardship is about more than voting. This explains what stewardship and engagement are, as well as outlining key considerations for schemes in building effective stewardship, engagement and voting policies. This includes practical checklists and a glossary of key terms;
- ▶ The PLSA's Corporate Governance Policy. What investors should look for when it comes to assessing corporate behaviour and governance overall – what does good corporate behaviour look like?
- ▶ The PLSA's Voting Guidelines. This goes through each of the key issues of interest to investors (such as audit, remuneration and climate change) and explores what investors should look for from companies – what 'good looks like' – where they might find key evidence and metrics to help them make a decision, which resolutions are most relevant and how investors should consider voting.

There are also a number of deep-dives into key issues including:

- ▶ Climate change resolutions – how do investors decide which to support?
- ▶ The role of securities lending in good stewardship
- ▶ How to hold asset managers to account
- ▶ The role of voting in pooled funds
- ▶ The importance of individual accountability

Finally, the appendices provide a glossary of key terms, signpost investors to other stewardship and voting frameworks and also offer a chart which summarises our voting recommendations both by issue and action.

## THE PURPOSE OF THIS GUIDE

Recent years has a seen huge changes in the expectations on pension scheme investors to demonstrate that they are active and engaged stakeholders – some regulatory, some reflect the growing awareness of the impact of climate change, and some reflect the increasingly activist society in which we now live. This past year, which has seen discussions about the role of ESG factors take centre stage, as well as new climate related reporting requirements in the Pensions Schemes Act, there is ever more e scrutiny of how pension schemes are investing and protecting their assets.

The PLSA has long been active in helping its members engage with investee companies – either directly or working through their advisers and managers – to protect and enhance the value of savers’ capital. We support schemes to act as good stewards of their assets and fulfil their fiduciary duty to beneficiaries.

The 2018 changes to the Occupational Pension Schemes (Investment) Regulations 2005 broadened the definition of stewardship to “engagement and voting”. These two aspects are linked and complementary. Voting activity should not be considered in isolation from (what should be) an investor’s ongoing dialogue with companies and its broader stewardship strategy.

## WHO THIS GUIDE IS FOR AND HOW TO USE IT

The resources and expertise that UK investors – and scheme investors in particular – have for stewardship varies widely. This guide is intended to be useful to investors from across the investment chain and with different levels of knowledge and expertise on stewardship, engagement and voting.

The guide can either be read from start to finish or be dipped in and out of as appropriate.

Pension schemes decision-makers (with less stewardship knowledge). We recommend reading the first few chapters on pages 7-21 before discussing our Voting Guidelines on pages 25-61 with your advisers and managers.

Pension scheme decision-makers (with more stewardship knowledge). Although we believe that this guide is useful for all types of scheme decision-makers on developing a stewardship strategy, there may also be benefit from going directly to page 23 on the PLSA’s 2021 Corporate Governance Policy and then our updated Voting Guidelines for the next AGM season on pages 25-61.

Investment consultants and asset managers. A key purpose of this guide is to support schemes in holding their investment service providers to account on the engagement and voting activity which is undertaken on their behalf. Service providers may benefit from going directly to pages 25-61 of the PLSA’s updated Corporate Governance Policy and Voting Guidelines to better understand the scheme perspective on key issues, although there may also be value in reading the earlier

chapters for additional insight into how the PLSA recommends schemes design their stewardship and engagement frameworks and approaches.

Company executives, including IR and HR professionals. Many companies use our Guidelines as a benchmark for their corporate reporting and engagement, to gain an insight into the scheme investor perspective. We recommend reading our 2021 Corporate Governance Policy and Voting Guidelines on pages 25-61.

Each chapter contains a summary of its contents to aid navigation.

## **THE PLSA APPROACH**

We do not believe that it is best practice to have an overly prescriptive approach to integration, stewardship or voting. The emphasis in this guide is on practical advice and issues to consider.

Scheme investors should take the time to think through what approach works best for them, how the approach fits most effectively with the investment style of their fund managers, what issues they wish to engage on and how the decision over to how to cast their vote fits in with their chosen stewardship approach and investment strategy.

Please note: although effective stewardship can be undertaken by investors across most asset classes – and investors will have an interest in good corporate governance beyond their equity holdings – this guide focuses on investor engagement with, and voting of, listed equity holdings.

## **PENSION SCHEME STEWARDSHIP RESPONSIBILITIES**

Many schemes will have outsourced the day-to-day stewardship and engagement activities to their asset managers or other service providers. This does not equate to delegated responsibility for engagement and voting activities. Where schemes are not undertaking voting decisions themselves, they still have a responsibility to monitor their service providers and challenge whether they are doing the best possible job on their behalf.

## THE POLICY FRAMEWORK FOR CORPORATE GOVERNANCE AND STEWARDSHIP

### WHAT IS CORPORATE GOVERNANCE?

Corporate governance is about ensuring that appropriate structures and individuals are in place to enable effective, entrepreneurial and prudent management, in turn delivering sustainable business success. It is not a matter of box ticking or mechanistic compliance; in fact, a compliance mind-set can undermine good corporate governance.

The PLSA believes that the underlying principles of all good corporate governance are accountability, alignment, transparency and integrity.

Truly effective corporate governance is, in the UK context, reliant upon a company's willingness to engage with the spirit of the Corporate Governance Code rather than simply about compliance with its Principles. In parallel, it is equally important that all institutional investors play their part and take their responsibilities seriously. Judgement and professionalism are required on all sides, as is a willingness to work intelligently towards the mutual understanding that the Code seeks.

### WHAT IS STEWARDSHIP?

Pension schemes are entrusted by savers to protect and enhance the value of their retirement savings. This requires them to take an active role – either directly or through their asset managers and other advisers – to monitor, engage and (where necessary) to intervene on matters which may affect the long-term value of investee companies.

Although the term “stewardship” is often used interchangeably with “ESG”, the issues upon which schemes should act as good stewards encompass anything potentially financially material: from strategy, performance and treatment of “traditional” financial risks to topics such as climate change, human rights or board and workforce diversity.

Stewardship must sit alongside the integration of long-term factors into investment decision-making. Where a pension scheme hires a fund manager, even the most active stewardship programme cannot substitute for poor investment decisions.

Pension schemes' stewardship role has come under increasing scrutiny from both policymakers and the public. It is important for schemes to work with their advisers and managers to monitor, engage with and ultimately hold accountable those individuals whom they have elected to the board.

### CORPORATE GOVERNANCE AND STEWARDSHIP: TWO SIDES OF THE SAME COIN

A strong UK corporate governance regime relies significantly upon investors – including pension schemes, even if not directly engaging with companies themselves – recognising and assuming their own stewardship responsibilities. The PLSA therefore supports the 2020 Stewardship Code and the mind-set that underlies it: that companies with engaged shareholders will perform better over the long run and this should have a positive impact on pension scheme members' savings.

We encourage companies to make efforts to identify their long-term investors i.e. those who are investing with long-term objectives – to enable regular and strategic dialogue with a critical mass of

engaged investors. Truly long-term and strategically focused businesses should be seeking out these investors. By improving dialogue and these key relationships, a company can make its shareholder base more stable.

The PLSA is always willing to facilitate active engagement between issuers and pension fund investors to discuss substantive matters of concern or company-specific issues. It is important that the dialogue between investors and companies takes place throughout the year, rather than being compressed into the period leading up to the shareholder meeting. The PLSA provides a forum for this dialogue to happen and is happy to initiate proactive engagement dialogues for our members with relevant companies on key strategic issues where we believe long-term value may be at stake.

Companies with robust governance structures can better handle ‘E’ and ‘S’ risks too. Although ‘E’, ‘S’ and ‘G’ issues are often examined in silos by investors, companies with effective corporate governance approaches and structures are more likely to effectively manage all the risks and opportunities which face them – this includes those which are environmental or social in nature.

## **REGULATORY BUILDING BLOCKS: STEWARDSHIP AND CORPORATE GOVERNANCE**

We believe that shareholders have a responsibility to work to ensure good governance at the companies in which they invest, one which goes beyond the latest shifts in policy and regulatory thinking. However, it is clear that developments in the policy environment can fundamentally alter the framework within which pension schemes and other investors exercise their stewardship responsibilities.

Increasingly we are seeing UK corporate behaviour, and the role of shareholders in this, is increasingly subject to media and policy maker attention. The role of the initiatives such as Climate Action 100, is increasing the profile of the voting behaviours of investors, particularly if it is not in keeping with over strategy. It is almost certain that, with impact of COVID being felt for some time to come, and the COP26 summit due to be hosted by the UK in November, climate change will continue to be at the forefront of investor considerations for the foreseeable future. The high profile collapse of the Arcadia Group in the past year has continued to ensure that the challenges of faced in Defined Benefit (DB) schemes when a company fails, and also on issues such as executive remuneration, audit quality, and corporate behaviour on dividend payments.

The next few sections go through some of the most fundamental ‘building blocks’ of the legal, regulatory and policy framework for corporate behaviour and investor stewardship. It is vital that schemes – even if they outsource their stewardship and voting activities – have a good understanding of the parameters within which they operate.

### **A. THE COMPANIES ACT 2006**

The directors’ duties, as set out in the Companies Act 2006, are the foundation of corporate governance. They include, in particular, the duty to promote the success of the company, while having regard to:

- ▶ The likely consequences of any decision in the long-term
- ▶ The interests of its employees
- ▶ Its need to foster the business relationships with customers and suppliers
- ▶ The impact of its operations on communities and the environment

- ▶ Its desire to maintain a reputation for high standards of business conduct

As such a proactive and effective board should provide the framework for discussing, managing and driving the long-term sustainability of the company.

## **B. THE UK CORPORATE GOVERNANCE CODE 2018**

The UK Corporate Governance Code establishes good practice according to the Principles that company board directors should apply to promote the purpose, values and future success of the company. We believe that how well a company has applied the Principles and the quality of their explanations to the Principles and Provisions must be used as a benchmark by investors in their scrutiny of firms' corporate governance approaches.

Unlisted companies may elect to follow the UK Corporate Governance Code but the UK's Listing Rules require premium listed companies to apply the Principles, comply with the Provisions and report to their shareholders on this.

The Principles must be applied by all eligible companies and how companies have done so – including any tailoring to allow for each company's unique circumstances – should be explained in the Annual Report. The Provisions of the Code should be followed on a 'comply or explain' basis: if a company finds that an alternative approach better achieves good governance, they must explain the situation clearly and concisely in the Annual Report.

In July 2018, the Financial Reporting Council published a significantly amended version of its UK Corporate Governance Code. The Code is structured into five sections:

- ▶ Board Leadership and Company Purpose
- ▶ Division of Responsibilities
- ▶ Composition, Succession and Evaluation
- ▶ Audit, Risk and Internal Control
- ▶ Remuneration

The new Code also gave greater scope for inclusion of the workforce voice in corporate governance discussion, highlighting a number of mechanisms for doing so:

- ▶ A director appointed from the workforce
- ▶ A formal workforce advisory panel
- ▶ A designated non-executive director

If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.

Our Voting Guidelines on pages 25-60 mirror the Corporate Governance Code sections but we also cover additional issues which we believe are particularly material to investors such as climate change and capital structure and allocation.

### C. THE UK 2020 STEWARDSHIP CODE

The Stewardship Code is a voluntary comply or explain initiative run by the Financial Reporting Council which “aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders.” The new Code includes a broader definition of stewardship which expects that in creating long-term value for clients and beneficiaries, stewardship will lead to sustainable benefits for the economy, the environment and society.

Since 2010, all UK-authorized asset managers are required by FCA Conduct of Business Sourcebook (COBS) to produce a statement of commitment to the UK Stewardship Code or explain why it is not appropriate to their business model. The vast majority of PLSA scheme members say that it is a requirement for any appointed asset management provider that it has signed up to the Stewardship Code.

The Stewardship Code was updated for 2020. The main changes included:

- ▶ An explicit reference to ESG factors
- ▶ A focus on stewardship beyond UK listed equities, into asset classes such as fixed income and infrastructure and assets invested globally
- ▶ A shift towards more outcome-focused reporting
- ▶ A new set of six Principles for service providers

The PLSA supports these changes and the principles of the Code. Asset owners are also able to sign up to the Code and we would encourage schemes to do so, as well as to require their asset managers to do so. Schemes should also ask their service providers about their intention to sign up to the new Code.

### D. CHANGES TO THE PENSION SCHEME INVESTMENT REGULATIONS

The last few years have brought about new responsibilities for pension schemes when communicating how they have undertaken their stewardship responsibilities:

- ▶ From 1 October 2019, the 2018 changes to the Occupational Pension Scheme Investment Regulations (2005) required pension schemes to set out in their Statement of Investment Principles (SIP) their policies on stewardship, including engagement and voting, as well as how they consider financially material environmental, social and governance (ESG) factors.
- ▶ 2020 brought the first implementation deadlines of the 2019 changes to the Investment Regulations, which implement the changes brought about by the European Union’s Shareholder Rights Directive II (SRD II). These require further detail on trustee stewardship policies to be added to pension scheme SIPs and implementation statements by various deadlines in 2020 and 2021 depending on the type of scheme.
- ▶ While DC schemes already have to publish information online, the 2019 changes mean DB schemes also need to publicly disclose their policies – and what they are doing – on their stewardship, ESG and shareholder engagement activities.

- ▶ Looking ahead, the first statutory deadline for the largest schemes to report in line with the Taskforce for Climate Related Financial Disclosures looks likely to come in on 1 October 2021 (subject to regulation). Over the coming years, it is likely that all schemes will be required to report on it.
- ▶ These latest, and future, changes have been a significant catalyst for the surge in scheme interest in ESG and stewardship approaches. They also mean that schemes will be under more scrutiny than ever on how they practice good stewardship.

## STEWARDSHIP: MORE THAN VOTING

Effective stewardship – ensuring that a scheme allocates, manages and oversees the capital entrusted to them by savers to create long-term value for their beneficiaries – is about much more than simply signing up to the latest collaborative initiative or casting a vote at an AGM. In fact, poorly considered and reactive stewardship practices can be counter-productive, leading to frustration for both investors and the companies involved.

For schemes to be effective stewards of their assets, they must work with their advisers to proceed step-by-step along the stewardship journey. For most schemes this will mean:

- ▶ Working through the scheme’s investment strategy, policy and objectives
- ▶ Developing and agreeing trustee investment beliefs
- ▶ Deciding the role both stewardship and the integration of ESG factors play within this framework
- ▶ Considering what constitutes an appropriate engagement strategy and plan
- ▶ Formulating an approach or policy for voting decisions
- ▶ Communicating expectations to service providers
- ▶ Monitoring and holding asset managers and others to account
- ▶ Assessing managers’ stewardship commitment
- ▶ Monitoring how votes are cast by fund managers in the interests of the scheme
- ▶ Measuring and reporting on stewardship outcomes by fund managers

We created the checklists below to guide schemes through these steps. Readers should note that this section does not aim to be a complete and prescriptive guide to stewardship.

Instead, we seek to offer some of the most important issues for consideration by investors and articulate which of the various aspects of voting and engagement trustees should consider as part of their broader stewardship approach.

## PLSA STEWARDSHIP CHECKLIST

To ensure an effective and meaningful stewardship strategy, scheme investors should:

### OVERALL POLICY AND APPROACH

- ▶ Be clear about how stewardship fits within their investment strategy, policy and how it helps meet their investment objectives. This should include:
  - ▶ A clear and agreed understanding of the trustee board and relevant organisations' (e.g. the employer's) overall mission, purpose and objectives
  - ▶ A defined set of agreed investment beliefs – including on ESG issues – at a level which ensures everyone is comfortable but which is also sufficiently granular to meaningfully inform and guide the investment strategy and objectives
  - ▶ A robust framework for deciding and monitoring a scheme's investment policies – including on ESG issues – and the role which acting as an engaged steward of members' assets plays in this. This can either be a standalone policy or fully integrated into a scheme's investment policies
  - ▶ A strategy for how stewardship fits into the manager selection process and ongoing relationship monitoring.
- ▶ Work with their advisers to consider the level of resource available for stewardship activities, which assets are covered and what the appropriate structure is. Some schemes have the resource for an in-house stewardship team. Others need to outsource stewardship either to their existing asset manager or to a specialist stewardship 'overlay' provider. It should be noted that delegating stewardship activities does not absolve schemes of responsibility. Instead they should take ownership of the stewardship approach and ensure they have a clear understanding of work taken on their behalf.
- ▶ Assess what stewardship arrangements are already in place and whether they remain fit for purpose. Schemes should not be afraid to challenge their existing service providers, including asking for practical examples of stewardship activities and – perhaps most importantly – outcomes.
- ▶ Decide what strategic issues – including environmental, social or corporate governance factors – are most material to the scheme. This decision is likely to be taken in consultation with both investment and legal advisers, as well as with employers – including any in-house sustainability or Corporate Social Responsibility (CSR) professionals. It could also include engagement with members to ascertain their views – although trustees must clearly communicate to scheme members that it is the trustee investment decision-makers who retain primacy in, and responsibility for, investment decisions.
- ▶ Have a clear policy on what kind of stewardship tools will be employed. This could include individual investor engagement, exercise of voting rights, collaborative engagement efforts or divestment. This should also include well-defined criteria for the escalation of engagement and a good voting policy.

- ▶ Schemes should also set out how they will employ these tools. For instance, how they will vote on certain matters – where possible – and through what means i.e. directly, delegated to their asset manager or through a specialist overlay service.
- ▶ A voting policy is a particularly helpful tool for schemes, enabling schemes to set out their views on a range of corporate governance, environmental and social issues so it can be used as a tool for discussion and communication with asset managers, companies and their consultants.
- ▶ Consider participating in public policy dialogues. Investor stewardship, including engagement and voting practices, takes place within a policy and regulatory framework that is shaped by a number of forces including the government, political parties, membership associations, campaign groups and public opinion. Where investors feel that the legislative framework does not sufficiently support them in acting as good stewards of their assets, they should seek to influence policy and regulatory initiatives. Those investors with fewer resources through this kind of activity could consider joining their voice with others, for instance through membership bodies or targeted collaborative initiatives.

#### **HOLDING SERVICE PROVIDERS TO ACCOUNT**

- ▶ Seek to ensure that fund managers and other service providers respond to this policy and objectives to deliver effective integration of long-term ESG factors into their investment approach. Using due diligence and the fund manager appointment process, pension schemes will gain a clear understanding of how prospective fund managers integrate ESG, stewardship and investment. Schemes should ensure that these approaches are fully consistent with their investment strategy, policy and objectives over the appropriate time horizon.
- ▶ Explicitly set out expectations for outsourced stewardship activities in legal documents. The most effective way of ensuring asset managers and other service providers are held to account on their stewardship work is to ensure expectations are clearly set out in legal documents such as the Investment Management Agreement (IMA).
- ▶ Agree a schedule for monitoring and reviewing outsourced stewardship activities. Working with advisers, scheme investors should consider how frequently and in what kind of forum to scrutinise their asset managers' stewardship and engagement activities on their behalf. This should include during manager selection (and RFPs) but an annual stewardship activity review would also be good practice.

#### **OTHER**

- ▶ Sign up to, or follow best practice guidance from, the FRC's Stewardship Code or other equivalent Codes in other jurisdictions. The Code sets out important principles for the role of institutional investors in monitoring and improving standards of corporate governance, as well as consideration of environmental and social issues, in the UK. Asset owner signatories to the

Code must demonstrate their commitment to the Code's spirit and communicate how they adhere to its principles to enhance and protect long-term value for scheme members.

- ▶ Agree a policy and approach for communication of stewardship activities to stakeholders. This should include with regulators and members. Disclosure is required in schemes' SIPs and implementation statements and for many a TCFD statement - but schemes could also consider a standalone stewardship or responsible investment report, additional information on members' annual benefit statements or in the Chair's Statement.

## **PLSA ENGAGEMENT CHECKLIST**

Stewardship is about more than just voting. The FRC recognises this in its Stewardship Code as does DWP in its 2018 changes to the Occupational Pension Schemes (Investment) Regulations 2005, which also broadened the definition of stewardship to include engagement. In fact, engagement is perhaps the primary means of effecting an investor's stewardship responsibilities.

To ensure an effective engagement strategy which results in purposeful dialogue, investors should:

## **OVERALL POLICY AND APPROACH**

- ▶ Decide the key issues for engagement. This should include financially material ESG topics. As for the stewardship strategy above, any decision should be taken in consultation with the employer(s), legal and investment advisers, as well as potential engagement with members.
- ▶ Agree how engagement will be used. This should include whether the scheme will engage directly with key companies on certain issues or whether such activity will be delegated to fund managers. It should also include an assessment of whether to engage with policymakers to raise awareness of an issue more generally or alter the regulatory framework.
- ▶ Agree a process for deciding what 'success' looks like. This should include documented decisions on issues such as what level of change is being sought and over what timescale, and at what stage an investor should decide to escalate its engagement. Examples of escalation include issuing a public statement, filing a shareholder resolution or collaborating with other investors or campaign groups – if not already part of the engagement process.
  - ▶ Some schemes will have the resources to engage and then, where engagement has failed, use a vote against a company on key resolutions as an escalation tactic. However, other schemes may not have these resources and may instead decide that voting is the only practical way to voice concern on an issue. Schemes must make sure they have an agreed policy and rationale for the approach they decide to take.
- ▶ Be open to engagement with companies on the full range of substantive matters. Investors should also be clear about their investment objectives when discussing governance and strategy with a company, so the Chair and directors are better able to understand what is expected of them. They should also make it clear to a company where decisions on both investment and voting rest.
- ▶ Work to ensure companies genuinely feel there is scope for explanations as well as compliance with the strictures of the Corporate Governance Code and other initiatives. Where the views of

boards and their shareholders differ on matters of corporate governance or ‘E’ and ‘S’ issues, constructive discussion should follow. However, ultimately schemes should be prepared to exercise their rights as owners to do what they see as necessary to protect the interests of their beneficiaries.

## **HOLDING SERVICE PROVIDERS TO ACCOUNT**

- ▶ Take time to understand the approach to engagement. Schemes should devote some time to understanding their asset manager’s or other providers’ ‘house’ approach to engagement, including when the asset manager decides to engage, how they apply voting sanctions and how the two fit together.
- ▶ Explicitly set out expectations for outsourced engagement activities in legal documents. As previously, schemes should ensure expectations are clearly set out in documents such as the Investment Management Agreement (IMA).
- ▶ Agree a schedule for monitoring and reviewing outsourced engagement activities. As previously, scheme investors should consider how frequently and in what kind of forum to scrutinise their asset managers’ engagement activities.

## **OTHER**

- ▶ Consider taking part in collaborative engagement initiatives. Combining a scheme’s voice with those of others across, or aligned with, the investment chain can be a powerful way of effecting change at companies on issues of shared interest. Collaborative engagement is also one of the few ways in which shareholders and bondholders can come together across different investment houses on the same issues.

## **COLLABORATIVE ENGAGEMENT**

The 2020 Stewardship Code defines collaborative engagement – often used interchangeably with the term collective engagement – in two ways: 1) as collaboration with other investors to engage an issuer to achieve a specific change and 2) working as part of a coalition of wider stakeholders to engage on a thematic issue.

The 2012 Kay Review noted that greater collective engagement could address concerns about fragmented and disparate ownership of companies, giving investors a greater voice. The PLSA believes that collaborative engagement can be helpful for both asset owners and managers to make the most of limited stewardship resources or AUM.

There are a number of different activities or tactics that investors can use collectively including: informal discussions with investors or companies; private or public letters; specific engagements with a company; or a formal agreement and initiative (including specific objectives, timescales and agreed tactics and programme for escalation).

The PLSA continues to run and join collaborative engagement initiatives on issues of clear concern to members. Effective collaborative engagement for scheme investors has a clear, well-targeted and time-specific objective that is explicitly linked to improving and protecting the value of scheme members' savings as well as clear legal boundaries and delineation of responsibilities for those leading, participating or providing the secretariat.

Schemes should ask their advisers and asset managers at both selection and review what collaborative engagement activities they have taken part in, including its objectives, impact, outcome and what role their service provider played in the initiative. If considering taking part in such an initiative directly, schemes should note that there is usually a trade-off between effectiveness and formality or time commitment required.

## **THE ROLE OF VOTING IN GOOD STEWARDSHIP**

How an investor casts its vote at a company Annual General Meeting (AGM) can be a powerful statement of either satisfaction or dissatisfaction with the approach of company management on specific issues. An effective stewardship approach is likely to be one which is backed up – where necessary – by voting sanctions.

### **THE ANNUAL GENERAL MEETING (AGM)**

At an AGM, company directors 'present' their annual report to shareholders. Shareholders also get the opportunity to ask questions as well as to express their views on issues of concern such as executive remuneration, business strategy or climate risk through casting their vote on related resolutions.

The AGM is an important part of the dialogue between a company and all its shareholders and is the occasion at which the board is held accountable for its actions during the preceding year. Shareholders should therefore make every effort to register their votes after careful consideration of the resolutions on the agenda.

Attending and speaking at the AGM is an effective way of expressing views about the company, not least when concerted attempts at engagement have failed to achieve a satisfactory resolution. It is also a good opportunity to hear the views of other shareholders – including retail investors whose opinions are not otherwise widely heard.

Since the UK entered the first period of Lockdown, in March 2020, virtual AGMs have become the 'new normal'. The Corporate Insolvency and Governance Act came into force on 26 June 2020, enabling AGMs to be held virtually, including retrospective measures applying to any held under such circumstances since 26 March 2020.

Prior to Lockdown, investors had not been supportive of virtual AGMs, and there is a certain apprehension that this period will result in virtual meetings becoming a permanent feature of AGM season. Data from Minerva Analytics shows that, though virtual AGM turnout increased over time, median turnout for 2020 decreased slightly – from 76.85% to 74.22%. A defeat of the article amendment at Standard Life Aberdeen to introduce virtual meetings suggests investors may be reluctant to make the switch a permanent one.

The PLSA supports the provisions introduced by the Government and companies to ensure that AGMs can happen virtual during these unprecedented times. However, given concerns about how this may reduce investor engagement, we would advise against voting against any motion that would make virtual AGMs permanent, rather than specifically linked to Government policy, or with a sunset clause attached. We would encourage investors to seek assurances from companies that they are looking at how to use virtual AGMs to not only protect investor engagement opportunities, but increase them.

Investors should expect boards to articulate clearly in their documents how they oversee and manage all material risks to their business model, approach and strategy. This helps investors form judgements on the management of these issues, informing their understanding of the effectiveness of the board oversight and guiding their approach to resolutions at the AGM.

Should an investor decide to vote against or abstain on a particular resolution, they should seek to explain to the company the reasons for doing so as early as possible.

Companies should publish AGM results as soon as practical after the meeting and should include in this disclosure a record of votes withheld. Where 20% of the votes on a particular resolution have not been registered in support of management (meaning both votes against and active abstentions) the board should acknowledge this within its Regulatory Information Service (RIS) statement and communicate as soon as reasonably possible how it intends to engage with shareholders to understand the reasons for dissent.

The company should then explain within the following year's annual report and accounts the steps it has taken, or will be taking, to resolve the concerns.

## **PLSA VOTING CHECKLIST**

There are several steps that investors can take to ensure they use their vote to wield maximum influence, including through clearly articulating their expectations to their service providers.

- ▶ While companies must avoid boilerplate explanations and provide thoughtful and justifiable explanations for any areas of non-compliance, shareholders also have a responsibility to:
- ▶ Evaluate explanations in an intelligent and non-mechanistic way for non-compliance by companies against the Code
- ▶ Take account of a company's individual circumstances
- ▶ Engage as appropriate, making sure that companies are aware of the reasoning behind a given vote on a contentious issue – often it is only through engagement that an investor can dig down more deeply into an issue of concern
- ▶ Ensure that voting decisions are always made in the context of a company's overall governance arrangements and consider the progress made, given that governance is always dynamic

To ensure a best practice and coherent approach to voting, which aligns with investors' stewardship and engagement policies, investors should:

## OVERALL POLICY AND APPROACH

- ▶ Establish a clear process for voting. Working with advisers, and referring back to the scheme’s investment objectives, stewardship beliefs and engagement approach, investors should consider what issues will be taken into account when deciding how to cast their vote. They should also balance this against the resources available for assessment and consideration of voting approach.
- ▶ Articulate an approach through formulating a voting policy on key issues. This should set out the approach to exercising voting rights. Consideration should also be given as to whether this should be published online with full access for the general public.
- ▶ Consider using the full set of voting powers. Powers which have historically been used more rarely include the approval of the annual report and accounts, the (re)appointment of the auditors, attendance and speaking at AGMs and tabling shareholder resolutions. Investors should make systematic use of all powers at their disposal to support the highest standards of governance.
- ▶ Be prepared to escalate when necessary. Investors should be ready to escalate in instances where it is clear that a given company is repeatedly failing to respond meaningfully to investors’ concerns on a specific issue. This should include holding individual Directors – including the Chair – responsible for areas of specific concern. However, investors should always balance the “signalling” effect of a voting sanction against the potential for it to exacerbate the situation which they seek to remedy.

## HOLDING YOUR SERVICE PROVIDERS TO ACCOUNT

- ▶ Set clear expectations with asset managers on how you want your vote to be considered and cast in pooled funds. A manager’s approach to voting in pooled funds should be a key issue when selecting a manager or deciding whether to invest in collective investment vehicles or nominee accounts (pooled funds). Schemes should be asking their manager to explain their approach to voting and what input is gathered from schemes in order to cast a particular vote.
  - ▶ If an asset manager does not allow for split voting in their fund, schemes should ask to see the asset manager’s voting policies across all those issues which the scheme has decided are most financially material to their portfolio and form a key part of their investment beliefs and objectives. If possible, this information should be provided on a fund level as opposed to the manager- wide level.
  - ▶ Schemes should also ask fund managers to evidence how the relevant E, S and G criteria have been applied in voting decisions.
- ▶ Outline your expectations regarding securities lending. There can be benefits from securities lending for investment portfolios. However, schemes should have a clear approach and policy to securities lending, including appropriate expectations and processes outlined in legal documents for asset managers, custodians and other service providers.

## OTHER

- ▶ Consider how you communicate your voting activities in required disclosures. This includes within your Statement of Investment Principles (SIP) and implementation statement. Scheme investors should work with their advisers and asset managers to ensure that they have a clear and consistent view of what is meant by a “significant” vote, making use of the PLSA Voting Reporting Template where necessary. Schemes should also consider the potential benefits of publishing – and making publicly available – their voting policy.

## SECURITIES LENDING

Securities lending refers to the act of temporarily transferring securities from a lender to a borrower. Securities lending can provide benefits to the lender – which includes institutional investors – enabling schemes to generate low-risk but small returns on their portfolios.

However, securities lending also results in a temporary transfer of ownership (including voting) rights to the borrower. Investors must therefore consider carefully how a securities lending policy might fit in with their stewardship approach, including effective exercise of voting rights.

Principle 12 of the 2020 UK Stewardship Code states that signatories must “actively exercise their rights and responsibilities” when it comes to securities lending. It is important that investors fully understand the potential implications from securities lending and balance this against the likely rewards.

Scheme investors’ expectations on securities lending by their asset managers and custodians should be set out clearly in relevant legal documents such as the Investment Management Agreement (IMA). Details covered should include timescales for and under what circumstances a manager will recall stock and whether the manager or custodian has a policy to temporarily suspend lending in a particular share ahead of a forthcoming vote, rights issue or other corporate action.

It should be noted that it is easier for a scheme to have a securities lending policy and agreement for a segregated mandate, as pooled funds might use several different managers. Asset owners might also have a separate securities lending relationship with the custodian and the asset manager may be unaware of this relationship, so it is important for schemes to work with their advisers to understand the nature of the contractual and practical relationships around securities lending.

## VOTING IN POOLED FUNDS

Schemes in the UK have historically been more used to segregated arrangements than their counterparts elsewhere in Europe. Larger schemes have also been accustomed to segregated services, but with a shift towards greater diversification and complexity of investments, pooled vehicles have been growing in popularity amongst schemes of all sizes.

While pooled arrangements can offer access to greater diversification and often (but not always) bring benefits in terms of lower costs, there are several issues to be considered. One of which is the level of influence the scheme has over how its voting policy and preferences are exercised.

When thinking about choosing a manager of a pooled vehicle, schemes should probe the manager's approach to voting. What is the manager's voting policy for pooled vehicles? And what is its policy for voting on the key issues that the client cares about? Schemes should make sure they get full details of the manager's voting policy – if it is not already publicly available – and ask for case studies regarding how the manager exercised its influence through votes to effect a particular outcome.

Schemes should make sure their expectations are clear to managers, including proactive engagement with the manager on issues that arise. For those managers who are Stewardship Code signatories, schemes should ask how they have reported in line with the Code expectation that fund managers explain their approach to allowing clients to direct voting.

Schemes should also ask for a regular voting report as part of the manager's responsible investment report (ideally issued to trustees on at least a half-yearly basis) and be prepared to take up with their asset managers any concerns which might have arisen about specific aspects of the asset manager's voting actions.

Schemes should be prepared to consider changing asset managers if their concerns are not addressed over a reasonable time period, or if they feel that their approach to voting and their manager's are not sufficiently aligned.

## THE PLSA'S CORPORATE GOVERNANCE POLICY

The PLSA's Corporate Governance Policy sets out our understanding of some of the key structures and processes that are required to support and protect good corporate behaviour. Our Policy builds on the regulatory and market context for both corporate governance and stewardship. It is firmly rooted both in the provisions of the Corporate Governance and Stewardship Codes as well as the underlying principles of accountability, alignment, transparency and integrity.

### WHAT DOES GOOD CORPORATE GOVERNANCE LOOK LIKE?

Investors should expect company boards to actively consider how the company's strategy, governance, arrangements, performance and prospects lead to the creation of value in the short, medium and ultimately long term. Building a sustainable business model which works for the long-term must be central to the business strategy.

We believe that good corporate governance is not just the preserve of large listed companies. However, when it comes to judging practice on the behaviour of smaller and medium companies, investors should be mindful of the individual circumstances of the business, reflecting upon its size and complexity. A key focus for smaller quoted companies should be to seek regular and constructive engagement with shareholders.

For their part, investors must communicate their expectations clearly to companies of all sizes regarding what they consider to be good corporate governance practices. We believe investors should use the following as a benchmark for good corporate behaviour overall:

- ▶ The company adheres to the spirit of the UK Corporate Governance Code. Good corporate governance is all about achieving long-term sustainable business success, not mere compliance. The PLSA would welcome less compliance as long as it is accompanied by more explanations that are insightful, purposeful and specific to the company's circumstances.
- ▶ Risk oversight and governance is considered holistically. Boards should set the cultural tone for the company and give full consideration to understanding and in turn mitigating long-term risks to the company's financial sustainability. This should include environmental, social and governance risks as well as more 'traditional' risks.
- ▶ There is prompt and effective corporate communication. This should cover all key corporate governance issues, including changes in board structures and responsibilities, remuneration policies, audit and efforts to monitor, assess and consider climate risk. Shareholders are becoming increasingly alert to corporate communication efforts that appear merely to 'go through the motions' instead of being a genuine attempt at engagement. Good communication greatly assists companies in developing good relationships with shareholders and avoids unnecessary surprises.
- ▶ There is no 'boiler-plating' and company communications provide relevant, accurate data and insight. Investors expect clear and specific explanations for non-compliance with Code provisions including relevant insights and a convincing rationale for choosing to override the provisions of the Code. Equally, shareholders must be prepared to listen and consider these

explanations. Good corporate governance and its reporting is a matter of principle and nuance, not dogma or mechanistic evaluation.

- ▶ Companies understand the importance of good engagement. Companies should take care to ensure their messages are clearly understood by investors. Investors in turn need to be confident that their concerns are communicated to, and considered by, the board. The roles of the Chair and the senior independent director (SID) in these regards are of the greatest importance.
- ▶ Perhaps the most important feature of good practice is transparency through the publication of adequate information which shares material insights and provides a reasonable basis for assurance.

## THE PLSA'S VOTING GUIDELINES

Our Guidelines aim to support scheme investors as well as their asset managers and proxy voting agents in forming judgements on the resolutions presented to shareholders at a company's AGM. The Guidelines can either be used by schemes making voting decisions themselves, or to inform them about the kinds of decisions their asset managers and proxy advisers will be taking on their behalf – helping them to more closely scrutinise their activities.

Our Guidelines are not intended to be prescriptive as we understand that investors of all kinds will take different approaches. Our Guidelines instead aim to help investors understand under what circumstances and how they should effectively apply a voting sanction.

Investors should take the decision to vote against management only after consideration of any explanation provided by the company for non-compliance with the Code and the extent to which investors' expectations have been met and previously raised concerns have been addressed. This should include consideration of particular circumstances and take place, ideally, after a meaningful engagement process – either individually or collaboratively – which gives sufficient time for the company to respond.

- ▶ **Under UK law, the resolutions tabled at a company meeting usually cover the following areas:**
- ▶ **Annual Report and Accounts**
- ▶ **Approval of the Remuneration Policy**
- ▶ **Approval of the Remuneration Report**
- ▶ **Re-election of the Chair**
- ▶ **Re-election of Directors**
- ▶ **Appointment of the Auditor and Authorise Remuneration of the Auditor**
- ▶ **Related Party Transactions**
- ▶ **Approve Final Dividend**
- ▶ **Issuance of New Shares**
- ▶ **Market Purchase of Shares**
- ▶ **Authorising Political Donations**
- ▶ **Articles**

## COMPANY ARTICLES

Company boards should regularly review their Articles, consult with major shareholders on material amendments and make the Articles readily available for inspection. Any changes must be accompanied by a clear and reasonable articulation by the board as to why they will not detract from shareholder value or materially reduce shareholder rights. If shareholder approval is sought for changes which are non-routine then this should be presented as a distinct voting item and should not be bundled into a single resolution with other matters.

## SHAREHOLDER RESOLUTIONS

In addition, investors may table their own resolutions, or support those tabled by others. When this happens, companies should provide a comprehensive outline of their position on the resolution and be available to engage with shareholders.

Shareholders should consider supporting proposals that will protect or further enhance shareholder rights and transparency and which aim at improving corporate reputation and/or the long-term sustainable success of the company.

## HOW TO USE THESE GUIDELINES

The Guidelines are split into sections that mirror the five relevant UK Corporate Governance Code Sections. We have also added separate sections on Climate Change and Sustainability, and Capital Allocation and Structure. There is also a final section which encourages investors to ‘take a step back’ and assess the company holistically, in line with the PLSA’s Corporate Governance Policy in the previous section.

Each section seeks to answer the following questions:

- ▶ What does good company behaviour look like?
- ▶ What are the relevant resolutions?
- ▶ How should investors consider voting (including appropriate resolutions for escalation)?

A key issue for schemes to consider on any issue is the level of disclosure. Without clear, sufficiently detailed and meaningful disclosures of information about a company’s board or its governance practices, it can be very difficult to arrive at an informed opinion about the quality of its compliance.

If investors are unhappy with the level of disclosure, they should very closely assess a company’s explanations of non-compliance with the Code. They should also consider this in their overall assessment of how to vote at a company’s AGM.

## HOLDING DIRECTORS ACCOUNTABLE

The PLSA believes that one of the most effective ways of using a vote to effect change is through holding relevant Directors individually accountable on core areas of concern.

However, investors continue to remain reluctant to do so. For instance, our analysis shows that investors continue to express high levels of significant dissent on remuneration-related votes i.e. on the remuneration policy or report, this is only rarely accompanied by a vote against the Remuneration Committee Chair or the Chair of the board. This is the case even when investors have repeatedly articulated their frustration regarding executive pay at specific companies.

Schemes have a fiduciary duty to their beneficiaries to act in their interests. This includes acting as a good steward of the assets entrusted to their care and part of that is taking responsibility for exercising voting rights in a way that sends the clearest possible message to companies that repeatedly fail to respond to legitimate investor concerns.

We strongly encourage scheme investors to communicate their expectations to managers and advisers as to how they expect their vote should be cast, including against individual directors.

Our Voting Guidelines focus on putting our stance on individual accountability into practice, offering guidance to investors on major issues as to who they should be holding accountable through their vote and under which circumstances.

## USING ASSET MANAGERS AND ADVISERS

We are aware that most schemes will outsource their voting activities to their asset managers, or to a specialist provider. In turn, many managers will rely on proxy service providers or other voting research services. The number of intermediaries involved makes it particularly vital that schemes make their expectations on stewardship, engagement and voting clear at the point of manager selection, in their legal documents and throughout their monitoring and scrutiny of asset managers.

It is important for managers to undertake dialogue with key companies. However, there are times when communication and engagement alone fails to achieve the desired objective.

Schemes must therefore ensure that they challenge their managers to back up their engagement actions with voting sanctions where necessary.

Similarly, schemes must be alert to any evidence of asset managers merely following the voting recommendations of the proxy service provider in all circumstances, instead of providing challenge and making their own judgements. Proxy advisers play a valuable role in the stewardship ecosystem, however – as with any other service provider – managers should be sufficiently engaged and equipped to dig beneath the skin of the adviser’s research and recommendations on key issues or companies.

Please note that schemes should balance this consideration against an appraisal of the areas where a manager has voted contrary to the recommendations of the proxy adviser but where the proxy adviser’s views and any recommendations are more closely aligned with those of the scheme.

We recommend schemes ask their managers as a matter of course for disclosure of voting – including contrary to the voting recommendations – and the rationale for the decisions taken.

## **SECTION 1: BOARD LEADERSHIP AND COMPANY PURPOSE**

An effective board is crucial to setting a positive company purpose, set of values and culture. The board should be diverse and committed to contributing to the long-term success of the company and the boardroom culture must enable each of the directors to contribute effectively and create a whole greater than the sum of its parts.

Company leadership, purpose and culture vary widely and investors should work with their advisers and managers to consider which issues are most likely to be material to value-generation. For instance, one company might have an issue with its supply chain and another an issue with staff retention.

### **THE ROLE OF CULTURE**

2020 has seen the role of culture within companies analysed as never before – ranging from diversity to the treatment of workforces through the pandemic, and in the most challenging of economic circumstances.

Cultural failures can damage corporate reputation and substantially affect investment returns. The 2018 UK Corporate Governance Code more clearly highlighted the role of the board in particular in determining and assessing a company's culture and values.

Culture is difficult to assess, but there are performance metrics available that can be helpful for raising questions. The PLSA has undertaken significant work on the value of an engaged, motivated and skilled workforce including a range of proxy metrics, tailored to specific sectors, for investors to use in assessing company culture through the use of different sources of information including their communications with employees, shareholders and wider stakeholders.

### **EVIDENCE BASE**

Shareholders will naturally look at financial results, as well as for wider evidence that the Chair and the board as a whole are adhering to the spirit of the Corporate Governance Code's Principles. For instance, significant pay discrepancies between a company's senior executives and the rest of the workforce, as well as gender or ethnicity pay gaps, can be signifiers of wider issues with a workplace's culture and processes.

Clarity on company strategy, culture and the business model should flow through every part of the Annual Report. This should include information on a company's employment model and working practices, given their materiality to a company's long-term performance, and how this is linked to the firm's culture and purpose.

The Annual Report should have clear information on workforce engagement and draw clear links between any employee survey findings, actions undertaken in response and the (expected) impact. Key metrics include employee turnover and employee survey follow-up.

The Strategic Report should clearly articulate how the company's key assets contribute to the generation of sustainable value creation. Clear connections should be apparent between chosen financial and non-financial priorities and KPIs selected by the company. Defined outcomes desirable for the company and its stakeholders should be measurable and incentivised by being integrated into remuneration arrangements that apply appropriate outcome measures over a reasonable time horizon.

Shareholders may want to undertake closer analysis of the narrative within company statements, noting the tenor and language used in describing the approach to the workforce and stakeholders and considering whether this bears out messaging from the Chairman and CEO statements about the aims and culture of the company. A feeling of alignment and consistency should be apparent throughout the document.

Leadership purpose and culture can be difficult to evaluate purely through reading company reports, however, and should be enhanced by shareholder engagement that has a central role to play in reviewing corporate behaviour and assessing performance on an ongoing basis.

The best indicators to use will depend on the situation, the context and the specific environment a company operates in. Investors should look for reliable and consistent sources of data, which allow comparison over time and with others in the sector.

#### **WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?**

- ▶ Corporate purpose, culture and values are aligned with company strategy. This alignment should continue through the recruitment, performance management and reward structures, all of which should be aimed at incentivising behaviour which is consistent with the company's purpose and values.
- ▶ Companies should be active in responding to the challenges posed by COVID on the workforce. For example, whether steps were taken to enable working from home and/or prioritizing the safety of staff, and what provisions were made to accommodate challenges caused by the virus.
- ▶ There is a clear link between good performance, the effectiveness of the board and results delivered in a way which is consistent with the company's stated strategy. Any weakness in performance should be adequately explained and should not be as a result of imprudent management, poor judgement or weakness in corporate governance that are not being directly addressed. Any weakness in performance should rather owe to external factors over which the board has limited control.
- ▶ Boards demonstrate awareness of their s.127 Duties under the 2006 Companies Act. This is a requirement for Directors to have regard to other stakeholders, including workers, customers, suppliers and wider society and the environment. This should include evidence of a plan for engagement with stakeholders, as well as activities undertaken and consequent outcomes.
- ▶ Boards demonstrate positive relationships with key stakeholder constituencies. Boards should be able to communicate how stakeholder perspectives are fed into boardroom considerations.

This should include shareholders – the quality of this dialogue is vital for assessing culture in particular.

- ▶ The Annual Report as a whole offers a fair, balanced and understandable assessment of the company's prospects and position. It should cover both financial and non-financial issues, and outline how the board has fulfilled its responsibilities.
- ▶ Company statements refer to the workforce as a source of value, not a risk to be managed. The 2018 Code explicitly clarified the company's responsibilities to shareholders and stakeholders – including its workforce.
- ▶ The Chair is engaged with the company's shareholders on governance and culture. Satisfactory engagement between company board members and investors is vital for a healthy UK corporate governance regime. The Chair should be accessible, accept legitimate shareholder requests for a meeting and convey relevant sentiments and dialogue back to the board as a whole.

## HOW INVESTORS SHOULD CONSIDER VOTING

The most appropriate route for registering general concerns would be voting on the Annual Report and Accounts. Investors should consider voting against adoption of Annual Report and Accounts if:

- ▶ Key stakeholder relationships –including with shareholders and the workforce – are being neglected and the board is not adhering to the spirit of the Corporate Governance Code requirement to have concern for stakeholder constituencies.
- ▶ Disclosure of the business model fails to convey how the company intends to generate and preserve long-term value.
- ▶ The company fails to provide a fair and balanced explanation of the composition, stability, skills and capabilities and engagement levels of the company's workforce.

More specific concerns related to the quality of the company's interaction with shareholders could be addressed by voting against the re-election of the Chair i.e. if:

- ▶ The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason, or has failed to find a mutually convenient time without undue delay.
- ▶ The Chair has repeatedly failed to address investors' concerns about the relationship with key stakeholders.
- ▶ The Chair has had significant involvement, whether as an executive director or a non- executive director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.

## **SECTION 2: DIVISION OF RESPONSIBILITIES**

### **SEPARATION OF THE ROLES OF CHAIR AND CHIEF EXECUTIVE**

A key role for the board is to scrutinise the operations and strategy of a company, ensuring the firm is operated in a way which aligns with its mission, purpose and in the interests of stakeholders and holding company management – including the chief executive – to account.

Separation of the roles of Chair – who should be transparently independent – and Chief Executive is therefore a cornerstone of good corporate governance in the UK. The contravention of this tenet by (a) the combination of the roles; or (b) the designation of an executive chair, should cause significant concern.

There are very limited instances where a temporary combination of the roles may be justified, notably when a Chair “bridges the gap” between the departure of a CEO and the appointment of their successor. Investors must probe companies carefully in these instances, ensuring that this short-term fix is being well-managed and that it does not persist excessively.

The succession of the CEO to Chair is a significant issue and is very rarely acceptable. It must be made clear that external search consultants were engaged and that external candidates of at least equivalent stature had been actively and fully considered.

### **DIRECTOR COMMITMENT**

The non-executive director role is an increasingly demanding one, particularly when chairing a key committee. It is crucial that directors have sufficient time and energy to fulfil their role properly.

### **EVIDENCE BASE**

Engagement with board directors, particularly with the Chair, gives investors the opportunity to assess the quality of the effectiveness of the board and its individual members.

The Annual Report should contain details of current appointments, including any changes over the previous year. Investors should be mindful of board directors’ concurrent directorships and take account of the size of the outside company, its complexity, its circumstances and other commitments that a director has in forming a view as to whether an individual director is over-committed.

The Annual Report should also clearly set out the ways in which the board has demonstrated its effectiveness and taken steps to address any areas for improvement. This should include insight into board-level training, assessment and outreach activities that have taken place throughout the year. It should also include an assessment of the board’s diversity of skills, experience and backgrounds.

## WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- ▶ Different roles and individuals work together collectively and effectively. The quality and mix of individuals should give investors reassurance as to the quality and openness of debate within the boardroom, the lack of dominance by any one individual and the avoidance of groupthink.
- ▶ The roles of Chair and CEO are fulfilled by different individuals. The two roles are distinctly different and should not, unless in exceptional circumstances, be held by the same person. Clear timescales for the persistence of this arrangement should be set out. Similarly, a company's chief executive should not become chair of the company. We would expect significant levels of engagement with shareholders were this to be the case, setting out the reasons for doing so.
- ▶ There is a transparently independent Chair and, upon new appointments, confirmation is provided to shareholders that the previous Chair was not involved in the appointment of their successor. If the Chair is not independent on appointment, the company should consult its investors and provide a detailed explanation as to why it considers the appointment desirable. In assessing the new Chair's suitability, shareholders must consider:
  - ▶ Their calibre, including skills, knowledge and experience
  - ▶ The balance of the board
  - ▶ The nature of the impediment to the proposed chair's independence
- ▶ The Nomination Committee anticipates change and ensures proper and timely succession planning. This includes ensuring boards are equipped with a diversity of perspectives, skills and experience and that each member is able to devote the necessary time to carry out their responsibilities. Boards should endeavour, where feasible, to consult their long-term investors over sensitive board appointments.
- ▶ Directors are able to commit appropriate time to the company. Investors should assess the evidence for other demands on directors' time as well as any significant developments which may have occurred since a director's appointment.
  - ▶ This is particularly pertinent to the role of chair – and especially where a company is both complex and global in scale, or if it operates in a highly regulated sector such as financial services.
- ▶ Clear mechanisms in place for shareholder communication. This must include the appointment of a Senior Independent Director (SID) as a key contact for shareholders when the normal channels of the Chair, CEO, or CFO have failed to address concerns or are not the appropriate avenue.
- ▶ Shareholders are given timely access online to terms and conditions on which directors are appointed. It is clear that due consideration has been given by the board and each director to the time commitment required, particularly in the event of a crisis developing.
- ▶ No current or prior relationships exist between independent non- executives and the company, which could compromise directors' ability to hold management to account. Shareholders should have a clear sense of any existing or pre-existing relationship between the independent non-

executives and the company. The 2018 Code draws out more clearly its expectations regarding the independence and responsibilities of non-executive directors.

- ▶ There should be a clear mechanism in place for engagement with the wider workforce. Companies should be clear about linking their engagement with their workforce to their broader strategy, values and mission.

## **HOW INVESTORS SHOULD CONSIDER VOTING**

We are aware that investors may feel uncomfortable voting against a combined Chief Executive/Chair given the pivotal role that a Chief Executive plays in a company (and the investment case). Some investors may therefore choose to vote against the Annual Report and Accounts to signal their concern, short of opposing the combined Chair/Chief Executive.

However, we feel that this may not be a sufficiently effective response to what is a very serious issue. We therefore believe that investors should consider voting against the election of the Chair if:

- ▶ There is a combination of the role of Chair and Chief Executive without a convincing explanation, where an ‘interim’ period extends for more than one year, or where there is evidence of poor succession planning
- ▶ They judge that the arguments presented to justify succession of the CEO to Chair are insufficient – complexity of the business is unlikely to be sufficient in itself as an explanation
- ▶ The Chair is director of more than four companies and/or a chair of two or more global and highly complex companies – unless there is a compelling explanation as to why this will not impact their availability and commitment
- ▶ The situation persists and there remain serious concerns that the specific arrangements create unresolvable challenges for board oversight of executive management
- ▶ Material corporate governance failings under the chair’s watch are evident. This should include an inadequate response in addressing shareholder concerns

Investors should consider also voting against the election of the Director responsible for the appointment process (often the SID).

## **SECTION 3: COMPOSITION, SUCCESSION AND EVALUATION**

### **COMPOSITION AND DIVERSITY**

There is clear evidence that diverse boards make better decisions and avoid behavioural biases such as groupthink or herding, enhancing board effectiveness. Although progress in recent years towards meeting the Davies target of 33% of women on FTSE 100 boards has been positive, there is still considerable room for improvement in some cases. Progress also remains slow in terms of ethnic diversity on boards, as highlighted by the Parker Review of boards. Investors must continue to press companies to maintain momentum, set clear timescales, and assess company disclosures on diversity carefully.

### **DIRECTOR (AND CHAIR) INDEPENDENCE**

This calls for a particularly thoughtful application of the “comply or explain” principle. Investors should consider the following factors in coming to their decision regarding independence:

- ▶ Overall corporate governance standards and history
- ▶ Evidence of independence in the director’s conduct, including holding management to account on particular issues
- ▶ Confirmation that independence (not just performance) was assessed in the board evaluation

### **SUCCESSION AND BOARD EVALUATION**

Continuous and evolving Board refreshment and succession planning is vital. It is critical that appropriate and sufficiently flexible succession plans are in place for the CEO and Chair.

An effective board evaluation process, which uses an independent external facilitator at least every three years, is an important part of a company’s governance processes.

### **EVIDENCE BASE**

While it is particularly difficult to get concrete metrics in this area, investors should look for progress over time and evidence that the company’s approach is changing for the better.

Company disclosures on succession planning in particular tend to be prone to the use of boilerplate reporting. Investors should look at the Annual Report with an eye to assessing how bespoke the narrative on succession planning is, including how well it is linked to the company’s overall strategy, values and mission.

Best practice disclosure on this issue includes:

- ▶ A board succession planning and nomination policy
- ▶ A rationale for re-election of each director
- ▶ Disclosure about the principles and process, including clearly defined parameters for and expectations of new appointments

- ▶ A clear discussion of the outcome of the board effectiveness review, including how the findings impact upon broader company value.

#### **WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?**

- ▶ The board has a clear vision about the optimal composition and a structured plan and times scales to achieve this. This should include: the ideal mix of experience and skills; gender, ethnic and other forms of diversity; and the proportion of the board that should consist of NEDs.
- ▶ Clear disclosure on succession plans. While some allowance should be made for the confidential or sensitive nature of some succession planning issues, disclosures should cover as much material information as possible including:
  - ▶ Any identified skills shortages
  - ▶ A focus on the Chair and CEO
  - ▶ An approach which looks out over multiple years
- ▶ Ownership of the succession planning approach by the company. The board should – through the Nomination Committee – retain ownership over the succession planning and recruitment strategy for both the board and for the Senior Management Team (SMT). Although the company may use external consultants, the board should ensure it remains actively involved.
- ▶ A well-balanced Nomination Committee. This should include the non- executive chair of the board, given the vital role they play in director performance evaluation.
- ▶ A clear and convincing rationale for Director re-election in the Annual Report. Such a statement should present shareholders with a full picture of the relevant skills and experience that a director is bringing to the board. It should also include:
  - ▶ A statement of a director’s other directorships, trusteeships and responsibilities – including those outside the corporate sector
  - ▶ The contributions they have made or will likely make to the board
  - ▶ Confirmation that the director has recently been subject to formal performance evaluation in relation to the fulfilment of their S.172 duties
- ▶ Detailed and considered explanations around Director independence. This should include why the company considers that the director remains independent despite the existence of any factors which may impair independence. It should also include justification as to why the independent element is sufficiently strong to counter any imbalance that may arise from the presence of one (or more) non-independent non-executive directors.
- ▶ A transparent and inclusive approach to the nomination process. This should include engagement with key shareholders, or other stakeholders such as employees.
- ▶ A consistent approach to board refreshment. This should include appropriate director mandates in terms of duration, and a clear link between director performance and re-election.
- ▶ Forward-looking and detailed succession and refreshment plans when proposing the re-election of long-serving members. The UK Corporate Governance Code stipulates that a board should state its reasons if a director has more than nine years’ tenure. This should not be considered to

mark a limit on the value offered by an individual, but a detailed plan is particularly vital when the director chairs an important board committee, including the following:

- ▶ There is evidence of a particularly rigorous review and evaluation process in the cases of long-serving members
- ▶ There is particularly clear disclosure as to why a long-serving non-executive director remains independent
- ▶ A clear link between implementation of the succession plan and company strategy. This should include the board's policy on diversity, including gender and ethnicity<sup>33</sup>, including its diversity objectives and progress towards achieving them. There should also be clear information regarding the efforts to develop talent internally.
- ▶ A clear description of the board's policy on diversity – including professional, international, gender and ethnic diversity. This should include any measurable objectives that it has set for implementing the policy, and its progress against these objectives. This should include the board's policy not just on its own diversity, but also on the diversity of the Senior Management Team (SMT). There should be a consistency in the company's strategy towards, and explanations of the contribution of, diversity (including cognitive diversity) and its link to corporate value over time.
- ▶ External board evaluations are conducted by a truly independent organisation. This is vital for any board effectiveness review to take an independent and rigorous approach. Companies should disclose details of the process – including the name of the firm or individual undertaking the board evaluation – and as far as possible the conclusions reached within the evaluation and subsequent actions taken. This should include details on the following:
  - ▶ When the review took place and when a subsequent review is planned;
  - ▶ What was specifically reviewed (including the rationale for this decision);
  - ▶ Who conducted the evaluation, whether they were internal or external; appointments and why they were selected;
  - ▶ The nature of the process;
  - ▶ Key findings and lessons learned, and whether any follow-up is required and if so, in what areas.
- ▶ Disclosure of details of any controlling shareholders, including the relationship agreement. Investors are increasingly concerned about controlling shareholders (defined by LR 6.1.2A) overriding the interests of minority shareholders. The relationship agreement must detail any entitlements to governance arrangements such as board appointments and be made available to investors – barring any commercially sensitive details.

## HOW INVESTORS SHOULD CONSIDER VOTING

Holding individual directors accountable on this particular area is especially vital if schemes are particularly unhappy with the composition of a board of company, including the plans for

succession and methods which have been used to ascertain how ‘fit for purpose’ an individual board member is.

Although voting against the entire board is usually the most powerful sanction an investor can apply, in this case, it is voting against specific individuals – alongside a clear and timely explanation from the investor as to why the vote is being cast – that can be most effective.

Investors should consider voting against the approval of the Annual Report and Accounts if:

- ▶ There is limited or boilerplate disclosure about the board evaluation and review of corporate governance arrangements
- ▶ A diversity statement is not disclosed, or is considered unsatisfactory Investors should consider voting against the re-election of the Chair if:
- ▶ Practice does not improve or there is consistently no independent board evaluation conducted

Investors should consider voting against the re-election of the Chair and the Chair of the Nominations Committee if:

- ▶ There is no evaluation process
- ▶ There is no clear evidence that diversity is being sufficiently considered by the board, or where previously committed timescales are not being met.
- ▶ There is a failure to disclose a reassuring succession plan, even after engagement with shareholders
- ▶ The board is consistently failing to move closer to the Davies Report target on female representation or the 2016 Parker report’s ethnic diversity target of no “all white boards” by 2021 (or other established targets for gender and other forms of diversity)
- ▶ There is a failure to move to annual director elections and an absence of an acceptable explanation

Investors should consider voting against the re-election of a Director (including re-election of the Chair) if:

- ▶ Previous legitimate investor concerns have not been sufficiently addressed
- ▶ The director has had significant involvement, whether as an executive director or non-executive director, in material failures of governance, stewardship or fiduciary responsibilities at another company or entity
- ▶ Engagement with a director has resulted in a judgement against their effectiveness and suitability, including with regards to conflict of interest
- ▶ There is no supporting statement from the board
- ▶ There is clear evidence of poor performance or poor attendance at meetings without provision of a satisfactory explanation
- ▶ There is concurrent tenure of a NED with an executive director for over nine years and no satisfactory explanation given as to why the director remains independent

- ▶ The composition of the key committees or the balance of the board has been compromised by the presence of one (or more) specific non-independent non- executive directors
- ▶ Where there is failure of a specific aspect of reporting or function (with investors voting against the Director responsible e.g. the Chair of the relevant Committee)

## SECTION 4: AUDIT, RISK AND INTERNAL CONTROL

The primary client of a company's auditor is the shareholder. Investors rely on a high-quality audit, where the auditors are fully independent and have exercised professional scepticism and judgement, to enable them to form a clear and accurate view of the financial health of the company.

Individual accountability here is key: if a named partner, or the Chair of an Audit Committee, has been involved in presiding over poor audit practices elsewhere, then investors should expect that the individual is not involved on an Audit Committee or involved in the audit at or of another firm.

Investors should note that the policy and regulatory framework for audit and investor engagement is likely to evolve rapidly over 2020 and 2021. This is in response to high-profile reports like the Brydon Review, which made a series of recommendations for engaging investors and enabling greater investor input, including:

- ▶ For the directors' Risk Report to be published in good time for shareholders to comment, as well as for a formal invitation to be issued to shareholders to express any requests they have regarding where they would be particularly keen for auditor focus in the audit plan;
- ▶ A standing item to be added to AGM agendas for questions to the chair of the audit committee and to the auditor;
- ▶ The establishment of the Audit Users Review Board, comprising users of audit reports to review proposals from and give advice to ARGA as to the evolution of audit.

### THE EXTERNAL AUDITOR

The role of the external auditor is to give an independent opinion on a set of financial statements and whether these show a true and fair value of the company. There should be regular refreshment and turnover in use of the external auditor to ensure that they remain impartial and able to exercise professional scepticism.

### RISK AND INTERNAL CONTROL

Risk management must be a prominent consideration at any company. Effective, robust and well-resourced internal audit has a central role to play in supporting boards to better manage and mitigate the risks the company faces. Firms should focus on risk in the context of the business strategy, the firm's size and global footprint, as well as its assets, liabilities and the wider political and regulatory environment.

The role of the internal auditor is key. It is their task to provide an annual internal opinion on the state of the organisation's arrangements in relation to risk management, governance and internal control. The internal audit function may also include an advisory or consultancy function, where they support management in improving systems and controls.

### EVIDENCE BASE

The key source of information on the auditor is the audit report. Investors should pay attention to the following information:

- ▶ Evidence of professional scepticism by the auditor;
- ▶ The critical accounting policies and principles used;
- ▶ The level of materiality adopted;
- ▶ Assumptions and judgements;
- ▶ The findings of any review undertaken by the FRC’s Audit Quality Review Team (and actions taken by the board in response to the findings)

Few investors are experts on audit assumptions and methodologies and there is an ongoing policy debate regarding to what extent investors can expect to be. The key determinant of a high-quality audit is professional scepticism and a willingness to challenge management.

Investors should be prepared to dig deeper and ask questions – via the Audit Committee or directly, if they have the necessary contact at the audit firms – including disclosure on areas where the auditor challenged management and the outcome, or even simply making a request – along the lines of the Brydon Review’s recommendations highlighted previously – that the auditor be present at the AGM to answer any questions and present their report.

On ESG metrics it is desirable that the sustainability metrics provided by companies be assured.

## **WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?**

### **AUDIT**

- ▶ The audited accounts represent a “true and fair” view of the state of affairs of the business. This should include its assets, liabilities, financial position and profit or loss – all of which should be prudently assessed to avoid overstating capital.
- ▶ The Audit Committee obtains a high-quality audit in the interests of shareholders, allowing for proper accountability between the audit company and the investors. The Committee has arguably the most complex brief of any of the board committees as objective and prudent accounts sit at the heart of an effective accountability regime.
- ▶ The Audit Committee demonstrates sufficient independence from company management. The Committee should be staffed solely by independent directors (both from the executive, but also taking into account independence from the external auditor) and enjoy sufficient relevant experience to carry out its responsibilities to a high standard.
- ▶ The Audit Committee Report provides ‘colour’ and detail. This should not simply mirror the auditor’s report. It should include the right quality and amount of information to give investors an insight into the audit process, including:
  - ▶ Explicit details of the criteria used for auditor selection and evaluation, including any contractual obligations to appoint audit firms;

- ▶ Details of the audit tender process, including when the audit was last tendered and how the company ensures independence is safeguarded
- ▶ How the Audit Committee satisfied itself that it got the highest quality audit possible
- ▶ Any changes to the process and plan of the audit (and reasons for these changes), including any changes to the audit partner and the process carried out by the audit committee to agree this appointment
- ▶ The Audit tendering process is in line with EU Regulations and has been rigorous. Any tendering process should enable the audit committee to compare the quality and effectiveness of the services provided by the incumbent audit with other audit firms – including those outside the Big Four. The intention to tender the audit contract should be disclosed in advance within the report and accounts and the process should focus on audit quality – not costs – including the auditors’ independence and processes to ensure professional scepticism.
- ▶ The Audit Committee fully discloses any members’ connections with the current or potential auditor. Committee members should also have recent and relevant financial experience related to audit, accountancy or investor practitioner expertise.
- ▶ Additional disclosures clearly cover any the reasons for any auditor resignation and fully detail all non-audit fees and policy on non-audit work. Where the auditors supply non-audit services to the company, the audit committee should keep the nature and extent of such services under regular and closer review, to ensure objectivity is not compromised. Disclosure of non-audit fees should include:
  - ▶ Clear break-down between the types of services received;
  - ▶ Tax compliance services are differentiated from tax advisory services;
  - ▶ Non-statutory acquisition-related services are separated from statutory services;
- ▶ Appropriate use is made of third parties for non-audit services (including outside the Big Four). Where the company also uses its auditors for non-audit work, the rationale for doing so much be clearly explained. No more than 50% of the audit fee should be spent on non-audit services.
- ▶ The AGM includes a presentation from the auditor. This happens increasingly rarely but the PLSA would be keen for this to take place more frequently. An appearance by the auditor at the Annual General Meeting would give investors the opportunity to directly ask questions and hopefully raise the profile of audit issues.

## **RISK AND INTERNAL CONTROL**

- ▶ The Annual Report covers the key elements of the business. It should explain how the company generates value from its key tangible and intangible assets. It should set out the board’s view of the key strategic and operating risks facing the business – including environmental, social, governance and reputational risks.

- ▶ The Annual Report covers emerging risks, demonstrating a dynamic approach to risk assessment. This could include risks from climate and cybersecurity, or tax management (and the potential impact on reputation and brand value). Companies should be communicating what changes have occurred in relation to their risks over the previous year, how it has chosen to respond and the impact so far – including likely impact on the overall business strategy and model.
- ▶ Directors state whether they expect the company to meet its liabilities as they fall due over the period of their assessment. This should include drawing attention to any qualifications or assumptions as necessary. This should be as part of an articulation as to whether they have a reasonable expectations that the company will remain a viable and sustainable enterprise for the foreseeable future.
- ▶ Directors articulate their reasons for choosing a specific time-frame. This should follow the FRC's guidance that the length of the period should take account of the board's stewardship responsibilities, previous statements they have made, especially in raising capital, the nature of the business and its stage of development.

## HOW INVESTORS SHOULD CONSIDER VOTING

Investors should note that in most cases, but not always, there are separate resolutions which cover the appointment of external auditors and the setting or authorisation of the board to set auditors' fees. This is important because investors may have concerns about the balance between audit and non-audit fees which need to be considered separately to the appointment of the auditor alone.

There is a range of resolutions that investors might use as a vehicle to express concerns regarding audit process or outcomes. These include: the vote to (re-)appoint the auditor; the vote to give directors power to agree the auditor's fee; the vote to approve the Report and Accounts; or the election of the chair (or other members) of the audit committee.

Investors should consider voting against the Report and Accounts and perhaps also the auditor and/or audit committee chair if there are ongoing concerns in relation to:

- ▶ The audited accounts fail to provide a true and fair view of profit or loss, assets or liabilities e.g. they overstate profit or assets, or understate likely liabilities (e.g. pension liabilities, climate-related liabilities) please note: if the auditor is seen to have helped reveal this issue then their re-election, all other things being equal, should be strongly supported
- ▶ There is ongoing use of alternative performance measures to report on business performance and their use is not transparent and fully justified, or where the reconciliation to the GAAP accounting numbers is unclear, or where the calculations change regularly in ways that appear to flatter management delivery
- ▶ There is poor disclosure of the strategy and risk exposures or a lack of disclosed review of the company's risk management and internal control systems
- ▶ There is either no viability statement which looks out over multiple years, or one which does not evidently consider a full range of risk factors

- ▶ The climate change assumptions that underlie calculations of relevant and publicly stated asset valuations or business profits are not sufficiently transparent or appear to be inconsistent with science and expert opinions on climate change

Investors should consider voting against the re-election of the Chair of the Audit Committee and reappointment of the auditor if:

- ▶ The tenure of an external auditor extends beyond ten years and there has not been a recent tender process and where no plans to put the audit service out to tender are disclosed
- ▶ The auditor has been in place for more than 20 years
- ▶ If the non-audit fees exceed 50% of the audit fee in consecutive years without an adequate explanation being provided
- ▶ There are major concerns regarding the audit process and quality of accounts – particularly a failure to provide a true and fair view, or good visibility over payment of dividends and these are not resolved satisfactorily by the board

Investors should consider voting against authorisation of auditors' remuneration (or the reappointment of the auditor if these resolutions are bundled if:

- ▶ The auditor's report fails to address a key issue or is otherwise unsatisfactory
- ▶ Audit fees have been either increased or reduced by a significant proportion (e.g. more than 20%) in a given year without a clear justification

Investors should consider voting against the re-election of the Chair if:

- ▶ There are extreme concerns or persistently poor disclosure

## SECTION 5: REMUNERATION

Remuneration is seen by many investors as a litmus test for wider corporate governance practices; it encompasses board effectiveness and leadership, challenge and oversight, as well as strategy and risk management.

Investors must continue to evaluate all aspects of a company's remuneration policies critically, with a view to ensuring that they are closely aligned with their interests and are driving long-term strategic success.

Investors should be aware that there is a significant and growing reputational risk from the issue of poorly managed executive remuneration – including for investors themselves and how well they are holding companies to account on this issue.

Significant pay discrepancies between a company's senior executives and the rest of the workforce, as well as those based on gender or ethnicity, can be a signifier of wider issues with a workplace's culture and processes. This has become particularly sensitive in the COVID era, where many companies have been made to make tough financial decisions relating to workforces, and made use of Government support in order to pay wages.

### EVIDENCE BASE

There will be several pages dedicated to executive remuneration in the Annual Report. However, it is vital that companies and shareholders also have appropriately regular discussions on strategy and long-term performance. Investors must use these engagements as an opportunity to encourage firms to directly link remuneration and corporate performance objectives.

Remuneration metrics should be considered in the context of the sector in which the company operates, the events of the past year, and what similar companies are doing in terms of their pay arrangements. There should be evidence of a range of long-term remuneration structures considered, with a convincing rationale as to why a particular approach – such as a Long Term Incentive Plan (LTIP) – was chosen over other approaches such as deferred stock options.

Investors should also ensure that there is a discussion of the remuneration quantum and not just the approach, bearing in mind the increased scrutiny from public and policymakers regarding big pay packages in an era where we are likely to face greater economic and market uncertainty.

### WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- ▶ Remuneration structures cascade down to all employees. Remuneration structures and incentives for executive directors should in some form cascade down to all employees in order to allow employees to also share in the success of the business. For example, companies should seek to offer employees share awards in the most cost effective and simple manner. This should also include executive pension contributions – rates for executive directors should be in line with those available to the workforce. This should be the case for both new directors and investors should engage as much as possible to ensure that this is the case for existing directors too.

- ▶ Maximum pay-outs must remain in line with the expectations of shareholders and other stakeholders, including workers and wider society. This should take into account the impact of the Coronavirus, the taxpayer funded support the company has received from Government in response to it, and the treatment of the wider workforce
- ▶ The pay policy should not enable any pay award larger than that necessary to successfully execute the company's wider strategy, and to incentivise and reward.
- ▶ There are clear time frames for bringing executive pension contribution rates for existing directors into line with those of the wider workforce. No compensation should be awarded for this change.
- ▶ New executive directors or any director changing role are appointed at the same level of pension contribution as for the overall workforce.
- ▶ The remuneration policy is clearly linked to incentivising behaviours which are consistent with the company's purpose and values. This should include performance on E and S issues and should demonstrate some recognition of wider societal expectations, the general economic environment and the returns to long-term shareholders.
  - ▶ Remuneration Committees should take as a starting point the company's strategic plan and KPIs and ensure there is a strong read across from the company's strategy to the drivers of executive remuneration.
  - ▶ This should include an aspiration in the near-term, if not already undertaken, to tie remuneration to company performance on relevant and material E and S metrics. Please note that this should be done in a way which does not incentivise the pursuit of sustainability at any cost and should be appropriate to the company context.
  - ▶ Where LTIPs are used, these should be linked to several different performance metrics, perhaps including a combination of growth, earnings and a mix of top-line and bottom-line contributions, in order to avoid incentivising short-term behaviour by executives.
- ▶ Pay schemes are clear, understandable for both investors and executives. Firms should not be operating multiple long-term schemes – a multiplicity of awards, with varying performance conditions is rarely successful in motivating company executives.
- ▶ The Remuneration Committee designs rewards that drive long-term success. Remuneration committees should take ownership of, and be accountable for, both the remuneration policy and its outcomes. Companies should consider how they might align pay more closely with the interests and expectations of their long-term owners in order to position themselves best for future success.
- ▶ The Remuneration Committee exercises its judgement, taking a critical and challenging approach to pay increases. Shareholders allow Remuneration Committees significant discretion and room to exercise judgement about the overall performance of the company when determining awards.
  - ▶ Even when Remuneration Committees are thinking about making executive salary increases that are in line with the average employee increase, consideration should be made to how competitive pay is already and to the extent to which this will increase all other areas of

remuneration (typically already at high multiples of salary and much higher than that available for employees).

- ▶ Consideration should be given to how the company has been impacted by the Coronavirus, the level of financial support accepted from Government, and how this might impact the perception of remuneration among stakeholders.
- ▶ Remuneration Committees should demonstrate that they are prepared to exert downward pressure on executive pay where necessary and that they have used their discretion to ensure that awards properly reflect business performance. This should include a willingness to scale back in light of wider factors relating to the company, its conduct, reputation and relationship with key stakeholders.
- ▶ Where Remuneration Committees have used their discretion in an upwards direction, they should explain appropriately.
- ▶ Remuneration Committees should consider how the results have been achieved, not just what was achieved including the creation of meaningful value and not just temporary stock price increases.
- ▶ Executive management makes a material long-term investment in shares of the businesses they manage. Senior executives should have significant “skin in the game” of the companies they manage. Importantly, this should not just arise owing to share awards, but be as a result of active purchase of shares by executives in the open market.
  - ▶ The bulk of variable rewards should flow over time from the benefits of being an equity owner.
  - ▶ Companies should also consider ensuring that executives are exposed to some tail risk for an appropriate length of time once they leave a company.
- ▶ There is a cap on variable pay and clear Remuneration Committee consideration of the overall quantum. There is no need for there to be a cap on fixed pay but Remuneration Committees should ensure there are set limits for variable pay (typically as a percentage of salary). They should also consider whether an overall pay cap (i.e. value of awards actually paid) may be appropriate in certain circumstances i.e. to ensure executives are not benefiting from windfall gains, particularly as a result of external factors which are outside of management’s control.
- ▶ There is a clear narrative to support the gender pay gap figures. This should include a well-targeted action plan for any improvement, including anticipated outcomes and how it links back to both the company’s strategy. The best companies will also be disclosing – in advance of likely future mandatory reporting requirements – their ethnicity pay gap and any supporting narrative.
- ▶ The company initiates appropriately regular discussions with investors on strategy and long-term performance. Any discussions on remuneration should be initiated at a sufficiently early stage in the process and include long-term investors who are committed to stewardship.

## HOW INVESTORS SHOULD CONSIDER VOTING.

It is important that investors note the difference between a remuneration policy and a remuneration report when it comes to choosing the right resolution on which to express a view. While one does impact the other, a vote for or against one does not necessarily require a vote for or against the other. Shareholders should view the separate resolutions independently.

On the Remuneration Report resolution specifically: given that this is advisory and that many companies remain too slow to heed the message on remuneration, the PLSA believes it is more appropriate for investors to vote against any remuneration report that they feel unable to support, rather than abstain.

Investors should consider voting against the Remuneration Policy if:

- ▶ The company's remuneration policy fails to meet the standards outlined above
- ▶ Pay policies may result in pay awards that could bring the company into public disrepute or foster internal resentment
- ▶ The pay policy awards 'sign-on' bonuses without the inclusion of any conditionality, or allows for the payment of awards not already vested at the previous employer
- ▶ The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role
- ▶ There is no provision to enable the company to claw back sums paid or scale back unvested awards – such provisions should not be restricted solely to material misstatements of the financial statements
- ▶ The pension payments or payments in lieu of pension (as a percentage of salary) for new appointments are not in line with the proportion paid to the rest of the workforce
- ▶ There is no plan to bring pension payments to incumbent directors in line with the proportion paid to the rest of the workforce over the next few years
- ▶ There is an excessive amount of flexibility being provided for 'exceptional circumstances'
- ▶ The recruitment policy is vague and unlimited or substantial headroom which is not then accompanied by substantial additional hurdles
- ▶ There are guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments
- ▶ There is any for re-testing of performance conditions
- ▶ New share award schemes are layered on top of existing schemes.

Investors should consider voting against the Remuneration report if:

- ▶ There is insufficient evidence of alignment with shareholders' interests and company long-term strategy. This could include, but is not limited to, a shareholding requirement for which the level is set at less than 2x salary

- ▶ The metrics used are inappropriate or there are insufficiently stretching targets for annual bonus or LTIP
- ▶ There are annual pay increases in excess of those awarded to the rest of the workforce and an absence of a convincing rationale
- ▶ Pension payments to incumbent directors (as a percentage of salary) are higher than the rest of the workforce and there is no evidence that payments have been introduced or any plans to reduce
- ▶ The pension payments or payments in lieu of pension (as a percentage of salary) for new appointments are not in line with the proportion paid to the rest of the workforce
- ▶ There is failure to disclose or retrospective disclosure of variable pay performance conditions for annual bonuses, or ex-gratia and other non-contractual payments
- ▶ There is a change in control provisions which trigger earlier and/or larger payments and rewards and an absence of service contracts for executive directors
- ▶ The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role

Investors should consider voting against the Remuneration Committee Chair (Director's election) if they have been in post for more than one year and:

- ▶ The company has repeatedly failed to take investors' concerns into account and respond in what investors consider to be an appropriate fashion
- ▶ The process of engagement pre-AGM has failed to result in a remuneration policy that shareholders can support, or shareholders feel that the Chair has failed to take on board their concerns about the remuneration report.
- ▶ Any revised policy continues, on a repeat basis, to fail to meet the principles outlined above

## SECTION 6: CLIMATE CHANGE AND SUSTAINABILITY

The unexpected events of 2020 have resulted in climate change becoming one of the prominent considerations for investors. Irrespective of how we ‘bounce back’ from the events of the past year, it’s clear that climate change is now a permanent feature in the minds of investors. Indeed, with increasing Government regulations and more activism in this space in the run up to COP26, companies should expect that the issue will only grow in prominence in the coming years.

Climate change is a corporate governance issue as well as a matter of environmental and social policy, and one that often touches on core company strategy. Boards should be expected to provide effective monitoring, assessment and oversight of the company’s approach to managing risks including those arising from climate change.

Companies should also disclose relevant material business issues and their strategic approach to addressing these, for instance their role in public policy and advocacy on related issues, as well as their membership of trade associations conducting similar activities.

The PLSA believes that climate change – or, rather, the climate emergency - is a systemic issue affecting nearly every industry and nearly every firm. Although the risks and opportunities arising as a result of climate change will impact some sectors more than others, most companies will need to assess the impact of climate change on their strategy and business model in the coming years if they are not already doing so.

While the issue of climate change is currently receiving significant focus, other sustainability issues – such as waste, deforestation, water usage/scarcity and biodiversity are also high on many investors’ agendas. Investors should be careful not to ignore non-climate sustainability issues and consider carefully which sustainability issues are most material to holdings in their portfolio and prioritise allocation of stewardship resources appropriately.

Please note: smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework, approach and timescales, but with a view to climate reporting becoming an expectation.

### EVIDENCE BASE

Premium listed companies are now required to report against the Task Force on Climate Related Financial Disclosures, and other listed companies are likely to fall within its scope in the coming years. The TCFD’s major step forward is to emphasise climate as a strategic issue that must be considered in the boardroom. The recommendations are split across different categories: governance, strategy, risk management, and metrics and targets and have been endorsed by investors representing trillions of dollars-worth of assets under management.

The largest companies are already reporting using TCFD: either separately, in their Sustainability Report or – as investors prefer – in their Annual Report.

The PLSA supports the TCFD approach and would expect to see listed companies report against or, or be making preparations to do so. This is in line with the Government’s TCFD Roadmap, which is likely to require all pension funds to provide TCFD reports within the coming years. The

PLSA believes that pension schemes should have access to as much information – including metrics and climate scenario testing – as possible regarding their investments to enable them to do so. It is mandatory for listed companies to measure and report on the greenhouse gas emissions they are responsible for producing. However, although this information is vital for investors when assessing how exposed their portfolio is to climate risk, it is not sufficient in itself and should be accompanied by a clear narrative surrounding the approach the company is taking to ensuring it manages this risk through its governance, processes and internal control arrangements.

Investors may prefer that companies take a joined-up approach in their discussions on climate change and other sustainability issues, both environmental and social. Due to the interrelated nature of climate change impacts, system-wide approaches and discussions – rather than single-issue responses – may yield more insights.

Given the systemic nature of the risk the climate emergency poses to companies, there could also be implications for capital structure and allocation. Investors should also carefully scrutinise disclosures regarding any planned capital expenditure on climate change related research and development, or whether any relevant merger and acquisition activity has been planned.

#### **WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?**

- ▶ Climate change is discussed in terms of strategic, financial and operational factors. The potential impact of different scenarios – including reactions from policymakers and regulators – on value creation in the long-term should be clearly discussed. There should also be a clear link to risk management at the executive level and risk oversight at the board level. The impact of climate risk and opportunities on the firm’s strategy over the short-, medium- and long-term should be clearly outlined.
- ▶ There are clear climate-related governance and oversight structures and processes. This includes climate change expertise at board level, identification of which Director is accountable for climate issues and management’s role in assessing and managing climate-related risks and opportunities. Every Director should demonstrate an understanding and awareness of the potential range of impacts which climate change may have on the company.
- ▶ A proactive approach both to identifying and managing climate risks (and opportunities) and providing sufficient disclosures on climate change. Companies should be either reporting against the TCFD framework, or be preparing to do so. There should be clear evidence that companies are considering the issue of climate change across the high-level TCFD areas of governance, risk management, strategy, metrics and targets, and scenario analysis.
- ▶ The potential consequences of both expected physical impacts of climate change and transition impacts are actively considered and discussed in reporting. In terms of physical impacts of climate change, the resilience of assets and supply chains in the face of, for example, changing weather patterns and rising sea levels should be considered as relevant. Companies also need to demonstrate consideration of the potential impact of changes in public policy and regulation around the transition to a low carbon economy. The narrative reporting should reflect the level of financial disclosures provided

- ▶ Clear reference in the Annual Report and Accounts to, and use of, credible industry climate reporting metrics. This should include reference to the Taskforce on Climate-Related Financial Disclosures, SASB (Sustainability Accounting Standards Board) CDSB (Climate Disclosures Standards Board), or other established third party frameworks. Companies should provide explanations as to the rationale for their choice of framework and the extent to which, if at all, relevant metrics have been “blended” with others. Please note: smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework and timescales.
  - ▶ Disclosures refer to the Paris Agreement and mention Net Zero. Companies should disclose whether or not they have assessed whether their business model is compatible with commitments to mitigate global temperature increases (at either 2 or 1.5 degrees) and, where they do not feel this is currently the case, have outlined a process – complete with relevant timescales – under which they hope to achieve compatibility.
    - ▶ This should include a discussion of the metrics which the company has chosen to assess climate-related risks and opportunities in line with its strategy and risk management. These metrics could include Scope 1, 2 or (where relevant) Scope 3 greenhouse gas (GHG) emissions.
- ▶ Financial disclosures include transparency on the underlying assumptions used to calculate balance sheet valuations and earnings. Many key valuation and profit measures disclosed by companies depend on assumptions about future returns. Investors may wish to challenge the calculations and/or substitute alternative assumptions in their own financial analysis should there be concern that these may rely on the Paris Agreement not being delivered in practice. In order to be open to such discussion, companies should be transparent on the assumptions underlying their calculations.
- ▶ A company’s political donations and membership of trade associations are aligned with their stance on climate change. Investors have become increasingly concerned about corporate support for organisations and individuals whose lobbying activities and objectives are considered to frustrate climate change mitigation. Such support may take the form of political donations, trade association membership, or the establishment of charitable or educational trusts that undertake lobbying against progressive climate legislation.

## HOW INVESTORS SHOULD CONSIDER VOTING

Investors should consider voting against the Report and Accounts if:

- ▶ There is insufficient disclosure (both level and quality) on how a company intends to monitor and manage the risks and opportunities brought about by climate change
- ▶ The business has operations which are highly carbon intensive and there has been no disclosure of the climate-related assumptions which underlie their financial calculations, or where those assumptions are not consistent with the Paris Agreement

- ▶ The business has operations which are highly carbon intensive and there is no commitment to disclose memberships and involvement in trade associations that engage on climate-related issues

Investors should consider voting against the Remuneration Policy if:

- ▶ There are no plans to align senior executive remuneration to performance against relevant sustainability metrics within a reasonable timeframe
- ▶ The business has operations which are highly carbon intensive and has not included at least one climate-related metric in the calculation of executive incentives. The metrics also should not be contradictory.

Investors should consider voting against the re-election of the responsible Director or the re-election of the Chair if:

- ▶ Shareholders have attempted to engage on the issue and yet companies have still failed to demonstrate effective Board ownership, for example providing a detailed risk assessment and response to the effect of climate change on the business, or incorporating appropriate expertise on the board
- ▶ The business is large and it is not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDP, SASB or another established third party framework. For smaller businesses, they are not readying themselves at a pace proportional to the resources available and the Government's TCFD roadmap.
- ▶ The business has operations which are highly carbon intensive and has not made sufficient progress in providing the market with investment relevant climate disclosures including committing to publish science-based targets
- ▶ The company has not listened to investor concerns about any direct or indirect corporate lobbying activity whose objectives are considered to frustrate climate change mitigation
- ▶ The company has not responded appropriately to the result of a climate change related resolution, whether binding or not, and whether it was actually passed or not
- ▶ Investors should also consider voting in favour of relevant climate-related or similar resolutions.

## **CLIMATE CHANGE RESOLUTIONS: WHAT SHOULD INVESTORS LOOK FOR?**

Though they still remain rare, the last few years have seen a growth in the number of climate-related resolutions being tabled at AGMs. Organisations can use these for awareness-raising and as part of a public campaign as well as to effect change.

If an investor judges that climate risk is particularly material to a holding in their portfolio, then they should strongly consider supporting resolutions tabled by others – or tabling a resolution themselves if they have sufficient resources – which ask or require companies to either disclose

what they are doing to mitigate climate risk or take concrete action to achieve specific climate-related targets where this is in the broader shareholder interest.

Questions which investors should be asking when deciding whether to support a given resolution

- ▶ Does it conflict with other climate resolutions? If so, which one will be most effective in achieving aims in line with the impact on the portfolio?
- ▶ Has it been supported by management?
- ▶ Does it focus on disclosure of activities and action – i.e. taking a behavioural approach which is trying to nudge companies into particular behaviours – or on the substance?
- ▶ If the resolution covers issues applicable across a sector, have similar requests been made of other companies in the industry, or is there a justifiable reason why the company has been singled out for attention?
- ▶ Does it clearly link to internationally agreed targets and agreements such as the Paris Agreement?
- ▶ Is the resolution binding? If so, is the request proportionate? Is there a good understanding of its likely impact on all relevant stakeholders, if passed? Would it impact the ability of the target company to make strategic decisions without seeking further shareholder approval in the future? Or does it offer some flexibility?
- ▶ If the resolution is non-binding (sometimes known as “precatory”), is the aspiration sought appropriate and consistent with the business’ long-term success? What actions would be appropriate for the company to take in response to the resolution? If those actions were not taken, how concerned would the investor be?
- ▶ Would voting against resolutions on political donations, re-election of the responsible director or the Annual Report and Accounts better reflect specific concerns on a particular area i.e. lobbying?

## SECTION 7: CAPITAL STRUCTURE AND ALLOCATION

Capital structure and allocation is the process of distributing a company's financial resources to enhance the firm's long-term financial stability and protect capital value. It can appear unexciting – and so often receives little attention from investors – but a mis-judged approach can contribute to corporate collapse and failure.

Capital allocation practices include re-payment of debt, repurchasing shares, paying final or interim dividends to shareholders and investment either in organic growth or in M&A activity. There are several stakeholders whose interests need to be balanced in any capital allocation decision, including the DB pension scheme, shareholders, employers and customers and the appropriate ratios between profitability and dividend payments must be maintained.

Although some of the issues highlighted below can seem technical or of low priority, investors should be alert for the signs of patterns of behaviour which suggest that the company continues to fail to honour shareholder rights. In 2016 BHS went into administration following several corporate governance failures including payment of illegal dividends. The total dividends paid by BHS Ltd between 2002 and 2004 were £414 million, almost double the after-tax profits of the company of £208 million. For its part, Carillion paid out £376m over a five-year time period while generating £159m of net cash from operations. Carillion also paid an interim and final dividend every year from 2010.

### DIVIDENDS

Information on dividend structure, including both policy and practice will be of interest both to equity investors who are looking for income or growth potential, and bond investors who are considering a company's long-term credit-worthiness.

### NEW SHARES

In company law, companies must secure shareholder approval to be able to issue new shares. Resolutions that allow the company to issue new shares are normally of two types: 'Section 551' and 'Section 570' Authorities.

#### *RESOLUTION TYPES: ISSUANCE OF NEW SHARES*

- ▶ *Section 551 Authorities* allow companies to allot new shares. Any amount in excess of one-third of existing issued shares should only be applied to fully pre-emptive rights issues in order to protect against shareholder dilution.
- ▶ *Section 570 Authorities* allow companies to issue shares for cash without the application of pre-emption rights. The Pre-Emption Principles<sup>43</sup> are equivalent to 5% of the issued share capital at the time of the Authority. An additional 5% is acceptable provided that the company confirms in its AGM circular that it intends to use this only in connection with an acquisition or specific capital investment which is announced at the same time as the issue, or which has taken place in the preceding six-month period. A multi-year limit also applies to the issuance of shares for cash otherwise than in connection with an acquisition of specific capital investment (typically a

maximum of 7.5% shares to be issued over three years without the application of pre-emption rights).

## **SHARE BUYBACKS**

Rule 9 waivers are usually sought where a company proposes to institute a share buyback programme in which a large investor or concert party intends not to participate. This brings with it the risk of creeping control – which is a clear issue of concern to shareholders.

Resolutions on dividends, share buybacks or issuance and debt constraints in articles need to be set within a considered capital structure framework. This framework should balance the need for shareholder returns with the long-term viability of the business.

## **EVIDENCE BASE**

Dividend information can be found in several different corporate communications, including the annual report, interim accounts, press releases and preliminary announcements. It should be noted that companies often fail to clearly articulate the story of the dividend, from policy development – including the rationale for its approach – to declaration and payment. Although there should also be a justifying statement around the dividend, this does not always happen.

The Viability Statement should also provide a basis for an annual assessment and debate on capital structure. However, these rarely provide as much useful and high-quality information as they could do – it is notable that the Brydon Review recommended the production of a Resilience Statement to perform a similar function.

Key metrics for investors to pay attention to should include the “payout ratio” where dividends are set as a percentage of a defined metric (this could be earnings or free cash flow). Where this is used – and particularly when the ratio is not based on a defined IFRS metric such as earnings of cashflow – the rationale for the selection of metrics should be justified.

The Annual Report should disclose Related Party Transactions which are significant, whether by virtue of their significance to the business, the individuals involved or the perception of potential conflicts.

## **WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?**

- ▶ Companies take capital structure decisions which balance the financing needs of the firm with the interests of broader stakeholders. This includes striking the right balance between dividend payments to shareholders and paying Deficit Repair Contributions (DRCs) to any Defined Benefit (DB) pension scheme, and undertaking share buybacks only when doing so is the best way of achieving long-term value. Dividend resolutions should not simply be approved as a matter of course, and moves that weaken a company’s balance sheet – and so its long-term stability – are not in long-term shareholders’ interests.

## Dividends

- ▶ Companies have clear dividend policies. These should set out the circumstances for distributing dividends and returning capital to shareholders. There should be evidence that the financial position (especially distributable reserves), maturity and strategy of the business – including the necessary level of Deficit Repair Contributions to any DB scheme – have been appropriately considered and reflected. Investors should pay attention to the possibility of companies taking on more leverage to cover dividends to shareholders.
- ▶ Dividend policy disclosure is specific. The information given should be at a sufficiently granular level so that investors can understand what the policy means in practice, including the basis for deriving the proposed level of dividend and the specifics of how it is determined. It should describe: the governance process over the policy decision, the risks and constraints associated with the policy and the timeframe over which the policy is expected to operate.
- ▶ There is a prudent level of interim dividends issued. Such dividends are usually decided solely by directors without the need for shareholder approval. There is a growing trend for companies to pay only interim dividends which is detrimental to the role of investor oversight on this issue. Where a scrip dividend or equivalent is issued, there should be a cash dividend also available.
- ▶ Shareholder approval is sought for the approval of the financial dividend. Should this not be the case, investors should strongly consider submitting a shareholder resolution or voting against the company's report and accounts, except where companies can compellingly demonstrate that changing their practice to seek shareholder approval of the dividend would significantly delay payment and do so to the material disadvantage of shareholders.

## Share buyback

- ▶ There is a clear rationale – one that aligns with the interests of long-term shareholders – for any share buybacks undertaken. Share buybacks can on occasion be a useful tool for companies to manage their capital structure and most investors will support these repurchases provided local market regulations and relevant shareholder guidance are met. However, share buybacks can be manipulated by managers whose pay is aligned with earnings per share and in a way which comes at the expense of long-term investors or the company's long-term success. Metrics and disclosure provided should cover:
  - ▶ The weighted average cost of shares bought
  - ▶ Total cost
  - ▶ Impact on key metrics for buybacks undertaken during the previous year
  - ▶ Clear explanation of the process used to identify when buyback is appropriate
  - ▶ The maximum price the company is willing to pay and the hurdle rate in respect of the buyback, linking to the overall capital management framework of the company.

### **Issuance of new shares**

- ▶ The company recognises that pre-emption rights are important for the protection of stakeholder interests. Companies should seek to abide by the recommendations of the Pre-Emption Group UK Statement of Principles except where they can make a clear case for these not being applied in the context of the best interest of all of the owners of the company concerned. To protect the rights of existing shareholders and reinforce the accountability of management to the company's owners, companies should avoid the creation of "poison pill" provisions except in exceptional circumstances.
- ▶ Any non pre-emptive issue is clearly signalled at the earliest opportunity. Companies should also seek to establish a dialogue with investors at this stage. They must keep shareholders informed of issues related to an application to disapply their pre-emption rights. The Pre-Emption Group Principles should be followed.

### **Related Party Transactions**

- ▶ There is a robust and independent process for reviewing, approving and monitoring related party transactions (RPTs). This should include both individual transactions and in aggregate and include appropriate procedures to identify and manage conflicts of interest.
- ▶ A committee of independent directors, with the ability to take independent advice, reviews significant RPTs and the board confirms that all RPTs have been reviewed and met with its approval. The Committee's review should include aggregate levels of RPTs to determine whether they are necessary, appropriate and in the best interests of the company and of shareholders.

### **HOW INVESTORS SHOULD CONSIDER VOTING**

There are several different resolutions pertinent to various capital allocation issues, including approval of final dividend; issuance of new shares; market purchase of shares; and Related Party Transactions.

Investors should consider voting against approval of the final dividend if:

- ▶ The dividend does not seem sustainable and appropriate, when considered in the context of the financial position, maturity and business strategy, or where issues such as Deficit Repair Contributions are not appropriately reflected
- ▶ There is no cash dividend available as an option to a scrip dividend or equivalent
- ▶ They have concerns regarding the accounting standards and assumptions used in the metrics provided

Investors should consider voting against a resolution on issuance of new shares if:

- ▶ Section 551 and Section 570 Resolutions are bundled together, or with any other issue
- ▶ The issuance is not consistent with Pre-Emption Principles without a satisfactory explanation

Investors should consider voting against a resolution on market purchase of shares if:

- ▶ The resolution proposes a waiver of Rule 9 of the Takeover Code
- ▶ The buy-back is not deemed a prudent use of the company's cash resources, are not supported by cash flows of the underlying business and introduces excessive and unsustainable leverage

Investors should consider voting against a resolution on related party transactions if:

- ▶ An RPT has not been subject to proper oversight by the board and regular review (through the audit or shareholder approval)
- ▶ The RPT is not: clearly justified or beneficial to the company; undertaken in the normal course of business; on fully commercial terms; in line with best practice; or in the interests of all stakeholders.

Investors should consider voting against a resolution on re-election of the Chair if:

- ▶ There is an unsustainable level of interim dividends issued and they have reason to believe that this is being done to avoid shareholder scrutiny. Please note: this is a serious issue and if investors have particular concerns in this space, they could accompany this with a vote against the Annual Report and Accounts
- ▶ Shares are issued outside of the Pre-Emption Group Principles

## SECTION 8: TAKING A HOLISTIC APPROACH

It is important for investors to do a stock-take after they have worked with their advisers and managers to consider their approach to voting on any company issues and to think about their views of the board as a whole. Voting decisions should be made in the context of a company's overall governance arrangements and should include consideration of the progress made – progress is always dynamic.

Investors should also consider the level of responsiveness of the board to investor concerns. Although it is mandatory for companies to address significant dissent votes and explain how the board will address the concerns that have led to the dissent, directors should be responsive to investor concerns throughout the course of the year and not just on a one-off basis, in specific circumstances.

### THE LEVEL OF DISCLOSURE

Investors need detailed and meaningful disclosures about a company's board and governance practices. Without this, it is very difficult to arrive at an informed opinion. Investors should reflect on whether the Annual Report adequately informs investors on the company's strategy, vision and business model.

If investors are unhappy with the level of disclosure overall or in key areas, this should be a significant factor in their holistic assessment of how to vote.

### ACCUMULATION OF MINOR ISSUES

Although certain minor corporate governance issues would not generally trigger voting consequences, an accumulation of minor issues may be indicative of poor corporate governance and more deep-rooted issues at a company itself. This is particularly the case if there fails to be meaningful progress – despite expressions of concern and engagement from investors – and it appears that the company management does not prioritise shareholder concerns.

### HOW INVESTORS SHOULD CONSIDER VOTING.

Investors should consider voting against the Annual Report and Accounts if:

- ▶ They feel this has not fulfilled its purpose of giving insight into the company's strategy, vision and business model

Investors should consider voting against the Chair or against the Senior Independent Director if:

- ▶ They have particularly serious concerns about the company's business model, plan or implementation of its plan for engagement with long-term shareholders
  - ▶ The company seems unwilling to change its approach in light of significant investor concerns
- Please note: where investors may wish to take the extremely significant step of voting against the whole board, they should be able to clearly articulate an alternative proposition for the board's approach.

## APPENDIX 1: VOTING RECOMMENDATIONS SUMMARY

| ISSUE                                | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)   |
|--------------------------------------|--|---------------------|---|
| Board Leadership and Company Purpose | Key stakeholder relationships –including with shareholders and the workforce – are being neglected and the board is not adhering with the spirit of the Code’s requirements to have concern for stakeholder constituencies | AGAINST             | Annual Report and Accounts  |
| Board Leadership and Company Purpose | Disclosure of the business model fails to convey how the company intends to generate and preserve long-term value  | AGAINST             | Annual Report and Accounts  |
| Board Leadership and Company Purpose | The company fails to provide a fair and balanced explanation of the composition, stability, skills and capabilities and engagement levels of the company’s workforce   | AGAINST             | Annual Report and Accounts  |
| Board Leadership and Company Purpose | The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason, or has failed to find a mutually convenient time without undue delay  | AGAINST             | Chair   |
| Board Leadership and Company Purpose | The Chair has repeatedly failed to address investors’ concerns about the relationship with key stakeholders  | AGAINST             | Chair   |
| Board Leadership and Company Purpose | The Chair has had significant involvement, whether as an executive director or a non-executive director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.       | AGAINST             | Chair   |
| Division of Responsibilities         | There is a combination of the role of Chair and Chief Executive without a convincing explanation, where an ‘interim’ period extends for more than one year, or where there is evidence of poor succession planning         | AGAINST             | Chair; Director responsible for the appointment process; (Annual Report and Accounts) |
| Division of Responsibilities         | The arguments presented to justify succession of CEO to Chair are insufficient – complexity of the business is unlikely to be sufficient in itself as an explanation   | AGAINST             | Chair; Director responsible for the appointment process; (Annual                      |

| ISSUE                                  | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)   |
|--|--|---------------------|---|
|  |  |                     | Report and Accounts)  |
| Division of Responsibilities           | The Chair is director of more than four companies and/or a chair of two or more global and highly complex companies – unless there is a compelling explanation as to why this will not impact their availability and commitment  | AGAINST             | Annual Report and Accounts; Chair; Director responsible for the appointment process   |
| Division of Responsibilities           | The situation persists and there remain serious concerns that the specific arrangements create unresolvable challenges for board oversight of executive management   | AGAINST             | Chair; Director responsible for the appointment process; (Annual Report and Accounts) |
| Division of Responsibilities           | Material corporate governance failings under the Chair’s watch are evidence. This should include an inadequate response in addressing shareholder concerns.  |                     | Chair; Director responsible for the appointment process                               |
| Composition, Succession and Evaluation | There is limited or boilerplate disclosure about the board evaluation and review of corporate governance arrangements  | AGAINST             | Annual Report and Accounts  |
| Composition, Succession and Evaluation | A diversity statement is not disclosed, or is considered unsatisfactory  | AGAINST             | Chair   |
| Composition, Succession and Evaluation | If:<br>Practice does not improve or there is consistently no independent board evaluation conducted<br>There is no evaluation process<br>There is no clear evidence that diversity is being sufficiently considered by the board<br>There is a failure to disclose a reassuring succession plan, even after engagement with shareholders | AGAINST             | Chair; Chair of Nominations Committee   |

| ISSUE                                  | PLSA STATEMENT  | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)             |
|--|---|---------------------|---------------------------------------|
| Composition, Succession and Evaluation | The board is consistently failing to move closer to the Davies Report target or the target set by the 2016 Parker report's ethnic diversity target of no "all white boards" by 2021 (or other established targets for gender and other forms of diversity)  | AGAINST             | Chair; Chair of Nominations Committee |
| Composition, Succession and Evaluation | There is a failure to move to annual director elections and an absence of an acceptable explanation   | AGAINST             | Chair; Chair of Nominations Committee |
| Composition, Succession and Evaluation | <p>If:</p> <p>Previous legitimate investor concerns have not been sufficiently addressed</p> <p>The director has had significant involvement, whether as an executive director or non- executive director, in material failures of governance, stewardship or fiduciary responsibilities at another company or entity</p> <p>Engagement with a director has resulted in a judgement against their effectiveness and suitability, including with regards to conflict of interest</p> <p>There is no supporting statement from the board</p> <p>There is clear evidence of poor performance or poor attendance at meetings without provision of a satisfactory explanation</p> <p>There is concurrent tenure of a NED with an executive director for over nine years and no satisfactory explanation given as to why the director remains independent</p> <p>The composition of the key committees or the balance of the board has been compromised by the presence of one (or more) specific non-independent non-executive directors</p> | AGAINST             | Chair; Directors                      |
| Composition, Succession and Evaluation | Where there is failure of a specific aspect of reporting or function (with investors voting against the Director responsible e.g. the Chair of the relevant Committee)  | AGAINST             | Chair; Directors                      |

| ISSUE                            | PLSA STATEMENT  | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)                       |
|----------------------------------|---|---------------------|---|
| Audit, Risk and Internal Control | <p>If there are ongoing concerns in relation to:</p> <p>The audited accounts fail to provide a true and fair view of profit or loss, assets or liabilities</p> <p>There is ongoing use of alternative performance measures to report on business performance and their use is not transparent and fully justified, or where the reconciliation to the GAAP accounting numbers is unclear, or where the calculations change regularly in ways that appear to flatter management delivery</p> <p>There is poor disclosure of the strategy and risk exposures or a lack of disclosed review of the company's risk management and internal control systems</p> <p>There is either no viability statement which looks out over multiple years, or one which does not evidently consider a full range of risk factors</p> <p>Climate change assumptions that underlie calculations of relevant and publicly stated asset valuations or business profits are not sufficiently transparent or appear to be inconsistent with science and expert opinions on climate change.</p> | AGAINST             | Auditor; Audit Committee Chair                  |
| Audit, Risk and Internal Control | <p>If:</p> <p>The tenure of an external auditor extends beyond ten years and there has not been a recent tender process and where no plans to put the audit service out to tender are disclosed</p> <p>The auditor has been in place for more than 20 years</p>   | AGAINST             | Audit Committee Chair; Reappointment of auditor |
|                                  | <p>If the non-audit fees exceed 50% of the audit fee in consecutive years without an adequate explanation being provided</p> <p>There are major concerns regarding the audit process and quality of accounts</p>  |                     |   |

| ISSUE                            | PLSA STATEMENT  | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)                        |
|----------------------------------|---|---------------------|--|
| Audit, Risk and Internal Control | The auditor's report fails to address a key issue or is otherwise unsatisfactory  | AGAINST             | Auditor's remuneration; reappointment of auditor |
| Audit, Risk and Internal Control | Audit fees have been either increased or reduced by a significant proportion (e.g. more than 20%) in a given year without a clear justification | AGAINST             | Auditor's remuneration; reappointment of auditor |
| Audit, Risk and Internal Control | There are extreme concerns or persistently poor disclosure  | AGAINST             | Chair  |

|              |   |         |                     |
|--------------|---|---------|---------------------|
| Remuneration | <p>If:</p> <p>The policy fails to meet the standards outlined by the PLSA</p> <p>The Pay policies may result in pay awards that could bring the company into public disrepute or foster internal resentment</p> <p>The pay policy awards ‘sign-on’ bonuses without the inclusion of any conditionality, or allows for the payment of awards not already vested at the previous employer</p> <p>The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role</p> <p>No provision to enable the company to claw back sums paid or scale back unvested awards – such provisions should not be restricted solely to material misstatements of the financial statements</p> <p>The pension payments or payments in lieu of pension (as a percentage of salary) for new appointments are not in line with the proportion paid to the rest of the workforce</p> <p>There is no plan to bring pension payments to incumbent directors in line with the proportion paid to the rest of the workforce over the next few years</p> <p>An excessive amount of flexibility being provided for ‘exceptional circumstances’</p> <p>A vague recruitment policy and unlimited or substantial headroom which is not then accompanied by substantial additional hurdles</p> <p>Guaranteed pensionable, discretionary or ‘one-off’ annual bonuses or termination payments</p> <p>Any provision for re-testing of performance conditions</p> | AGAINST | Remuneration Policy |
|--------------|---|---------|---------------------|

| ISSUE        | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION) |
|--------------|--|---------------------|---------------------------|
|              | Layering of new share award schemes on top of existing schemes   |                     |                           |
| Remuneration | If:  | AGAINST             | Remuneration report       |
|              | <p>There is insufficient evidence of alignment with shareholders' interests and company long- term strategy. This could include, but is not limited to, a shareholding requirement for which the level is set at less than 2x salary</p> <p>The metrics used are inappropriate or there are insufficiently stretching targets for annual bonus or LTIP</p> <p>There are annual pay increases in excess of those awarded to the rest of the workforce and an absence of a convincing rationale</p> <p>Pension payments to incumbent directors (as a percentage of salary) are higher than the rest of the workforce and there is no evidence that payments have been introduced or any plans to reduce</p> <p>There is failure to disclose or retrospective disclosure of variable pay performance conditions for annual bonuses, or ex-gratia and other non-contractual payments</p> <p>There is a change in control provisions which trigger earlier and/or larger payments and rewards and an absence of service contracts for executive directors</p> <p>The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role</p> |                     |                           |

| ISSUE                             | PLSA STATEMENT  | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)                                   |
|-----------------------------------|---|---------------------|---|
| Remuneration                      | <p>In the event:<br/>           The company has repeatedly failed to take investors' concerns into account and respond in what investors consider to be an appropriate fashion<br/>           The process of engagement pre-AGM has failed to result in a remuneration policy that shareholders can support, or shareholders feel that the Chair has failed to take on board their concerns about the remuneration report<br/>           Any revised policy continues, on a repeat basis, to fail to meet the principles outlined by the PLSA</p>   | AGAINST             | Remuneration Committee Chair (if in post for over one year) |
| Climate Change and Sustainability | <p>If:<br/>           There is insufficient disclosure (both level and quality) on how a company intends to monitor and manage the risks and opportunities brought about by climate change<br/>           The business has operations which are highly carbon intensive and there has been no disclosure of the climate-related assumptions which underlie their financial calculations, or where those assumptions are not consistent with the Paris Agreement<br/>           The business has operations which are highly carbon intensive and there is no commitment to disclose memberships and involvement in trade associations that engage on climate-related issues</p> | AGAINST             | Report and Accounts   |

| ISSUE                             | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION) |
|-----------------------------------|--|---------------------|---------------------------|
| Climate Change and Sustainability | <p>If:</p> <p>There are no plans to align senior executive remuneration to performance against relevant sustainability metrics within a reasonable timeframe</p> <p>The business has operations which are highly carbon intensive and has not included at least one climate-related metric in the calculation of executive incentives, or climate-related metrics. These metrics also should not be contradictory.</p> | AGAINST             | Remuneration Policy       |

| ISSUE                             | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION) |
|-----------------------------------|--|---------------------|---------------------------|
| Climate Change and Sustainability | <p>If:</p> <p>Shareholders have attempted to engage on the issue and yet companies have still failed to provide a detailed risk assessment and response to the effect of climate change on their business, and incorporate appropriate expertise on the board</p> <p>The business is large and is not already moving towards disclosures consistent with mandatory TCFD obligations, CDP, SASB or another established third party framework, and smaller businesses are not readying themselves at a pace considered proportional to the resources available and the Government's TCFD Roadmap.</p> <p>The business has operations which are highly carbon intensive and has not made sufficient progress in providing the market with investment relevant climate disclosures including committing to publish science-based targets</p> <p>There is no commitment to disclosing within a reasonable timeframe in line with CDP, SASB, TCFD or another established third party framework, or to meet mandatory reporting requirements.</p> <p>The company has not listened to investor concerns about any direct or indirect corporate lobbying activity whose objectives are unhelpful to mitigating climate change</p> | AGAINST             | Directors; Chair          |
| Climate Change and Sustainability | Shareholders may also wish to consider supporting relevant climate related or similar resolutions. Key issues to be considered when doing so should be the proportionality and achievability of the resolution.  | FOR                 | Shareholder resolution    |

| ISSUE                            | PLSA STATEMENT   | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)      |
|----------------------------------|--|---------------------|--------------------------------|
| Capital Structure and Allocation | <p>If:</p> <p>The dividend does not seem sustainable and appropriate, when considered in the context of the financial position, maturity and business strategy, or where issues such as Deficit Repair Contributions are not appropriately reflected</p> <p>There is no cash dividend available as an option to a scrip dividend or equivalent</p> <p>They have concerns regarding the accounting standards and assumptions used in the metrics provided</p> | AGAINST             | Approval of the final dividend |
| Capital Structure and Allocation | <p>If:</p> <p>Section 551 and Section 570 Resolutions are bundled together, or with any other issue</p> <p>The issuance is not consistent with Pre-Emption Principles without a satisfactory explanation</p>   | AGAINST             | Issuance of new shares         |
| Capital Structure and Allocation | <p>If:</p> <p>The resolution proposes a waiver of Rule 9 of the Takeover Code</p>  | AGAINST             | Market purchase of shares      |
|                                  | <p>The buy-back is not deemed a prudent use of the company's cash resources, are not supported by cash flows of the underlying business and introduces excessive and unsustainable leverage</p>  |                     |                                |
| Capital Structure and Allocation | <p>If:</p> <p>RPTs have not been subject to proper oversight by the board and regular review (through the audit or shareholder approval)</p> <p>The RPT is not: clearly justified or beneficial to the company; undertaken in the normal course of business; on fully commercial terms; in line with best practice; or in the interests of all stakeholders.</p>   | AGAINST             | Related party transactions     |

| ISSUE                            | PLSA STATEMENT  | VOTE OUTCOME (VOTE) | VOTE OUTCOME (RESOLUTION)                   |
|----------------------------------|---|---------------------|---|
| Capital Structure and Allocation | If:<br>There is an unsustainable level of interim dividends issued and they have reason to believe that this is being done to avoid shareholder scrutiny<br>Shares are issued outside of the Pre-Emption Group Principles | AGAINST             | Chair                                       |
| Taking a holistic approach       | If reports and accounts did not fulfil its purpose of giving insight into the company's strategy, vision and business model   | AGAINST             | Report and Accounts                         |
| Taking a holistic approach       | There are particularly serious concerns about the company's business model, plan or implementation of its plan for engagement with long-term shareholders   | AGAINST             | Chair; Senior Independent Director; (Board) |
| Taking a holistic approach       | The company seems unwilling to change its approach in light of significant investor concerns  | AGAINST             | Chair; Senior Independent Director; (Board) |

## APPENDIX 2: GLOSSARY OF STEWARDSHIP TERMS

**ANNUAL GENERAL MEETING (AGM)** This is a company meeting for its shareholders which takes place once a year, after the company's year end. It can be held in person or electronically/online. Public Limited Companies (PLCs) must hold an AGM within six months of the company's year end. Private companies must hold theirs within nine months of their year end. While PLCs are required to hold an AGM, private companies are not. The AGM provides an opportunity for shareholders to ask questions of senior management on issues and to vote on key resolutions.

**COLLABORATIVE ENGAGEMENT** Although engagement can also be undertaken by an individual investor, collaborative (or collective) engagement takes place when an investor works with other investors or stakeholder groups. This can be undertaken in an informal and loose-knit way – such as the PLSA's engagement with FTSE 100 companies on workforce disclosure issues – or more formally through coalitions such as Climate Action 100+ .

**ESCALATION** The process by which investors use progressively more targeted, public or more stringent approaches and tools in order to influence a company on an issue of concern. The 2020 Stewardship Code Principle 11 emphasises the need for any escalation to have well- defined objectives and a clear rationale for the shift in engagement approach and escalation tactics chosen.

**EXTRAORDINARY GENERAL MEETING (EGM)** This is any other general company meeting for shareholders outside the AGM. An EGM may be called when there is an important issue facing a company on which a shareholder vote is necessary and must take place before the next AGM. Examples of when an EGM may be called include urgent votes on issues such as a company takeover, a change to the company's name, a change to the company's Articles of Association or to dissolve the company.

**REMUNERATION** The dialogue between an investor and the investee company. Ideally, this should be well-structured, with clear objectives and timescales and a strategy for escalation. This can take a number of forms, from a generic letter to bespoke meetings with individual companies.

**RESOLUTION** A resolution is the method by which shareholders vote in order to approve company decisions, including whether to re-appoint the auditor, whether to re-elect Directors or approve the Report and Accounts. There are two kinds of resolutions.

Ordinary Resolutions are used by companies for routine matters (such as those outlined above). For Ordinary Resolutions, a simple majority of 50% is enough for the resolution to pass. More important issues – such as changes to the Articles of Association – require the tabling of Special Resolutions which require at least 75% of votes to be cast in its favour to pass. Usually it is the directors of a company who decide which resolutions should be tabled. However, shareholders with 5% or more of the total voting rights can require the company to circulate a resolution to be voted on at the company's AGM.

**PROXY VOTE** This is where shareholders who are unable to attend an AGM can appoint a proxy to attend and vote for them. Shareholders can either instruct their proxy how to vote on their behalf, or let the proxy take the voting decision themselves. Proxy advisers are used by investors to support them with research, information and recommendations on shareholder proposals and resolutions.



## **APPENDIX 3: THE 2018 UK CORPORATE GOVERNANCE CODE**

### **SECTION 1: BOARD LEADERSHIP AND COMPANY PURPOSE**

#### Principles from the UK Corporate Governance Code

- A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success for the company, generating value for shareholders and contributing to wider society.
- B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.
- C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.
- D. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.
- E. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.

### **SECTION 2: DIVISION OF RESPONSIBILITIES**

#### Principles from the UK Corporate Governance Code

- F. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.
- G. The board should include an appropriate combination of executive and non- executive (and in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.
- H. Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.
- I. The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

### **SECTION 3: COMPOSITION, SUCCESSION AND EVALUATION**

#### Principles from the UK Corporate Governance Code

J. Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for board and senior management. Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

K. The board and its committee should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.

L. Annual evaluation of the board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively.

#### SECTION 4: AUDIT, RISK AND INTERNAL CONTROL

##### Principles from the UK Corporate Governance Code

M. The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative instruments.

N. The board should present a fair, balanced and understandable assessment of the company's positions and prospects.

O. The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

#### SECTION 5: REMUNERATION

##### Principles from the UK Corporate Governance Code

P. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration

should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy.

Q. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome.

R. Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.

## **APPENDIX 4: FURTHER READING AND RESOURCES**

### **The Corporate Governance Principles and ICGN Global Governance Principles.**

These globally accepted standards of best practice provide a sound foundation for the development of market-specific codes of best practice for investors to adopt and support as part of their corporate governance programmes.

[www.icgn.org/images/Global\\_Governance\\_Principles\\_2014.pdf](http://www.icgn.org/images/Global_Governance_Principles_2014.pdf)

### **The QCA Code for Small and Mid-Size Quoted Companies**

While the UK Stewardship Code only applies on a mandatory basis to companies with a premium listing, its principles are just as relevant to smaller quoted companies as they are to larger ones. The Quoted Companies Alliance (QCA) Corporate Governance Code for Small and Mid-Size Quoted Companies is a useful reference point for companies in this respect. In judging practice, investors should be mindful of the individual circumstances of the business, reflecting upon its size and complexity. A key focus for smaller quoted companies should be to seek regular and constructive engagement with their shareholders.

<https://www.theqca.com/shop/guides/143861/Corporate-governance-code-2018-downloadable-pdf.shtml>

### **The AIC Code of Corporate Governance (Investment Companies)**

Investment Companies have specific characteristics which commonly lend themselves to alternative governance approaches than those set out in the Code. To that end, the Association of Investment Companies (AIC) Code of Corporate Governance forms a comprehensive guide to best practice. Of particular importance to shareholders is that the board is, and acts, fully independently of the firm providing fund management services. The board of these companies is crucial in ensuring that shareholders are provided with sufficient information for them to understand the risk/reward balance to which they are exposed by holding the shares.

<http://www.theaic.co.uk/aic-code-of-corporate-governance-0>

### **PLSA Corporate Governance and Stewardship website**

<http://www.plsa.co.uk/PolicyandResearch/Corporate-Governance/Stewardship.aspx>

### **PLSA Understanding the worth of the workforce: A Stewardship toolkit for pension funds**

<https://www.plsa.co.uk/Policy-and-Research/Document-library/Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds>

### **PLSA More light, less heat: A framework for pension fund action on climate change**

<https://www.plsa.co.uk/Policy-and-Research-Document-library-More-light-less-heat>

### **PLSA ESG and Stewardship: A Practical Guide to Trustee Duties**

<https://www.plsa.co.uk/Policy-and-Research/Document-library/Responsible-Investment-Guide-2019>

**The UK Corporate Governance Code (2018)**

[www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx](http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx)

**The UK Stewardship Code (2020)**

[www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx](http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx)

**The PLSA Voting Reporting Template and Implementation Statements Guidance**

<https://www.plsa.co.uk/Policy-and-Research/Document-library/Implementation-Statement-guidance-for-trustees>

**OECD Principles:**

[www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm](http://www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm)

**IVIS Guidelines:**

[www.ivis.co.uk/Guidelines.aspx](http://www.ivis.co.uk/Guidelines.aspx)

**GC100 and Investor Group Guidance on directors' remuneration reporting**

<http://uk.practicallaw.com/groups/uk-GC100-investor-group>