THE MEMBER BACKING PENSIONS AND LIFETIME SAVINGS ASSOCIATION

PLSA STEWARDSHIP & VOTING GUIDELINES 2023

MARCH 2023

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ABOUT US

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintech's and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

ACKNOWLEDGEMENTS

The PLSA would like to thank the members of the PLSA Stewardship Advisory Group for their input and continued policy guidance. We would also like to thank Minerva Analytics.

EXECUTIVE SUMMARY

Political and economic events and circumstances have a direct impact on the evolving topics investors engage with when it comes to stewardship.

The fast-moving pace of global and domestic events during the last year gave rise to a financial and energy crisis that has had a sustained effect on UK households, with inflation reaching record highs. As a result, executive remuneration, which has already been an area of focus in recent years, is now in the spotlight again, as the UK economic growth is stalling and the wider workforce is struggling through a cost-of-living crisis; as such the PLSA calls on companies to show restraint in their executive pay.

The Task Force on Climate-Related Financial Disclosures (TCFD) are now, or will soon be, requirements for most pension schemes, and investee companies should expect heightened scrutiny from investors on climate related issues. All listed companies should continue to reference TCFD in their reporting.

The PLSA supports continued progress on workforce disclosures, but there is still work to be done. Companies are expected now to continue progress towards the 2024 targets for ethnic diversity on FTSE 250 Boards – and the recently added 2027 goals - as set out in the Parker Review. On gender representation, the FTSE Women Leaders Review – which continues the work of the Hampton-Alexander and Davies Review – has set out four new recommendations to achieve by the end of 2025. Its 2023 report highlights great progress, with FTSE 350 companies meeting the 40% target for women on boards three years ahead of the target date. However, efforts should also be taken forward to imbed better practices to increase wider diversity and inclusion – of all protected characteristics – in organisations. These will form the backbone of social and cultural practices within organisations, which is an area of increased focus for investors, who are expanding their investment focus to encapsulate not only environmental issues but also social factors.

The Covid-19 pandemic exposed a growing sentiment of the need to improve working conditions for staff. Mental health, alongside other wellbeing practices, should be at the heart of companies' workforce concerns. On wider workforce practices, it remains paramount that companies take steps to ensure that modern slavery is not taking place within their business or supply chains.

The move to home working during Covid-19, alongside the current geopolitical situation, has increased cybersecurity risks. Companies need to ensure they are managing these threats appropriately, by having governance and oversight structures in place and reporting on potential breaches and solutions.

These and other topics are covered in our 2023 Stewardship and Voting Guidelines, which continue to set out a comprehensive framework on how key issues need to be considered by schemes in their stewardship.

This guide is aimed at scheme investors, their investment service providers and companies interested in using the PLSA's guidelines as a benchmark for their corporate reporting and investor relation work. The principles set in this document, although drafted for a UK context, are globally applicable, and schemes may wish to apply this framework more broadly than just to their holdings in UK equities.

Below is an outline of key sections of the document:

- *The Policy Framework for Corporate Governance and Stewardship* – Reviews the new regulations on shareholder engagement and its implications for scheme investors. It also discusses how corporate governance and stewardship relate to one another.

- *A Holistic Approach to Stewardship* – Explains what stewardship and engagement are, as well as outlines key considerations for schemes building effective stewardship, engagement and voting policies. This section includes practical checklists.

- *The PLSA's Corporate Governance Policy* – Sets out what investors should look for when it comes to assessing corporate behaviour and governance overall. It seeks to address the overall question of "what does good corporate behaviour look like?"

- *The PLSA's Voting Guidelines* – Delves into each of the key issues of interest to investors (such as audit, remuneration, climate change and workforce) and explores what investors should look for from companies, further exploring what good corporate behaviour looks like. It also discusses where investors might find evidence or metrics to inform decisions.

- *The Appendices* – These provide a glossary of key terms; references to signpost investors to other stewardship and voting frameworks; and a chart summarising the PLSA's voting recommendations, both by issue and action.

PURPOSE OF THIS GUIDE

Investors continue in 2023 to focus on ensuring that scheme investment strategies keep evolving with social beliefs and expectations. Alongside the mounting number of disclosure requirements, the PLSA notes the growing view among its members that their investments should include credible Net Zero transition plans; it was a top priority for 56% of schemes surveyed by the PLSA in 2022.[1] Awareness and interest of the impact of investment in social issues continues to expand, with almost half (42%) of survey respondents in 2021 saying that they have a policy that specifically covers financially material social factors.[2]

The PLSA finds its members increasingly keen to have access to information on workforces; schemes participated in workforce reporting analysis in 2022 – undertaken with Railpen and CIPD – which revealed that participants want to feel reassured that greater attention is being given to employees' pay at a time where they are struggling the most.[3] This guide suggests how investors could tackle these issues in the current Annual General Meeting (AGM) season.

The PLSA aims to help 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.

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[1] Pensions and Lifetime Savings Association 'Around Three Quarters of Pension Schemes Have, or Soon Will Have, Net Zero Plans in Place', Pensions and Lifetime Savings Association (2022) <https://www.plsa.co.uk/Press-Centre/Press-Releases/Article/Around-three-quarters-of-pension-schemes-have-or-soon-will-have-Net-Zero-plans-in-place> [Accessed 22 February 2023].

[2] Pensions and Lifetime Savings Association 'Consideration of Social Risks and Opportunities by Occupational Pension Schemes', Pensions and Lifetime Savings Association (2021) < https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2021/Consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes-Jun-21.pdf>.

[3] Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen 'How Do Companies Report On Their 'Most Important Asset'?', Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) < https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf> [Accessed 22 February 2023].

- *Pension scheme decision-makers (with less stewardship knowledge)*: We recommend reading the first few chapters on pages 8-25 before discussing our Voting Guidelines on pages 26-75 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 in developing a stewardship strategy, there may also be benefit from going directly to page 23 of the PLSA's 2023 Corporate Governance Policy and then our updated Voting Guidelines for the next AGM season on pages 26-75.
- *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 23-75 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 Investor Relations and HR professionals*: Many companies use our Guidelines as a benchmark for their corporate reporting and engagement and to gain an insight into the scheme investor perspective. We recommend reading our 2023 Corporate Governance Policy and Voting Guidelines on pages 23-75.

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 stewardship or voting. The emphasis in this guide is on both sharing practical guidance as well as highlighting policy issues to consider when reviewing corporate governance and voting policies. 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 voting decisions fits in with their chosen stewardship approach and investment strategy.

Please note that 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.

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[4], rather than simply about compliance with the Code's "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) intervene on matters which may affect the long-term value of investee companies.

Although the term "stewardship" is often used interchangeably with Environmental, Social, and Governance, or "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 in 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 with whom they have elected to their board.

[4] Financial Reporting Council, 'The UK Corporate Governance Code' Financial Reporting Council (2018) <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF> [accessed 20 February 2023].

CORPORATE GOVERNANCE VS STEWARDSHIP: TWO SIDES OF THE SAME COIN

A strong UK corporate governance regime relies significantly upon investors. This includes 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[5] and the mind-set that underlies it, which is that companies with engaged shareholders will perform better over the long run and that this should have a positive impact on pension scheme members' savings. We also welcome the recommendations of the Taskforce on Pension Scheme Voting Implementation to government, regulators, and industry,[6] published in 2021, which recommended:

- Trustees should either set their own voting policy or acknowledge responsibility for the voting policies that asset managers implement on their behalf
- Trustees should make an assessment of the efficiency of the implementation of voting policies
- Where possible, trustees should set out an expression of wish on voting across all pension investment structures
- Industry should promote a vote disclosure template.

In 2022, alongside the Investment Association, the PLSA published a report[7] setting out several recommendations across the entire investment chain on how effective stewardship can ensure long term value creation. Those recommendations are set out in this document, as we believe this forms the blueprint for effective stewardship practices for asset owners.

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 within these key relationships, a company can make its shareholder base more stable.

Companies with robust 'G' (governance) structures can better handle 'E' (environmental) and 'S' (social) 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

[5] Financial Reporting Council, 'The UK Stewardship Code 2020' Financial Reporting Council (2020) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf> [accessed 20 February 2023].

[6] Department for Work and Pensions, 'Taskforce on Pension Scheme Voting Implementation: recommendations to government, regulators and industry' Department for Work and Pensions (2021) <https://www.gov.uk/government/publications/taskforce-on-pension-scheme-voting-implementation-recommendations-to-government-regulators-and-industry> [accessed 20 February 2023].

[7] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

effectively manage all the risks and opportunities which face them, including those which are environmental or social in nature.

REGULATORY AND STATUTORY BUILDING BLOCKS OF STEWARDSHIP AND CORPORATE GOVERNANCE

We believe that shareholders have a responsibility to work to ensure good governance at the companies in which they invest, going beyond the latest trends or 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.

The following sections go through some of the most fundamental 'building blocks' of the legal, regulatory and policy frameworks 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. We would encourage all schemes and asset managers to consider becoming a signatory to the Financial Reporting Council (FRC) Stewardship Code.

A. THE COMPANIES ACT 2006

A Directors' duties, as set out in the Companies Act 2006,[8] are the foundation of corporate governance. They include 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 by supporting the Director in carrying out these statutory responsibilities.

B. THE UK CORPORATE GOVERNANCE CODE 2018

The UK Corporate Governance Code establishes good practice (according to the Principles set out in the Code) that board Directors should apply to promote the purpose, values and future success of the company. In July 2018, the FRC 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

[8] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents> [Accessed 21 February 2023].

- 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.

We believe that how well a company applies the Principles of the Code – and the quality of its explanations – must be used as a benchmark by investors in their scrutiny of firms' corporate governance approaches.

Although unlisted companies may elect to follow the UK Corporate Governance Code, the UK's Listing Rules[9] require premium listed companies (companies that are expected to meet the UK's highest standards of regulation and corporate governance) to apply the Code's Principles, as well as its more detailed Provisions, and report on this to their shareholders.

How companies have done this – including any tailoring for each company's unique circumstances – should be explained in their 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.

Our Voting Guidelines on pages 26-73 mirror the five sections as laid out in the Code, but we also cover additional issues which we believe are particularly material to investors such as climate change, workforce, and capital structure and allocation.

C. THE UK 2020 STEWARDSHIP CODE

The Stewardship Code[10] is a voluntary comply or explain initiative run by the FRC which "aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders." Updated in 2020, the most recent 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. The PLSA supports these changes, which include:

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[9] Financial Conduct Authority, 'FCA Handbook' LR TR 13 Transitional Provisions for the UK Corporate Governance Code, Financial Conduct Authority <https://www.handbook.fca.org.uk/handbook/LR/TR/13/13.html> [Accessed 21 February 2023].

[10] Financial Reporting Council, 'The UK Stewardship Code 2020' Financial Reporting Council (2020) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf> [accessed 20 February 2023].

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

Since 2010, all UK-authorised asset managers are required by the Financial Conduct Authority (FCA) Conduct of Business Sourcebook (COBS)[11] to produce a statement of commitment to the UK Stewardship Code or explain why it is not appropriate to their business model.

D. OTHER RELEVANT CHANGES IN THE PENSIONS INVESTMENT REGULATORY LANDSCAPE

The last few years have brought about new responsibilities for pension schemes when communicating how they have undertaken their stewardship responsibilities, including for climate change risk investment.

Changes to Occupational Pension Scheme Investment Regulations

- As of 1 October 2019, the 2018 changes[12] to the Occupational Pension Scheme Investment Regulations (2005)[13] required pension schemes to set out in their Statement of Investment Principles (SIP) their policies on stewardship, including engagement and voting, and how they consider financially material ESG factors.
- 2020 brought the first implementation deadlines of the 2018 changes, which abide by the directive 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 SIP and the publication of annual Implementation Statements.
- While DC schemes are already required to publish information online, 2018 changes mean DB schemes also need to publicly disclose their policies – and what they are doing – on their stewardship, ESG and shareholder engagement activities.

Changes to Climate Related Regulations

- All schemes with Assets Under Management (AUM) of more than £1 billion, plus all authorised Master Trusts, are now required to produce an annual TCFD report, according to regulations set out by the Department for Work and Pensions (DWP). A review of extending the requirements to smaller schemes will take place in 2023. Though not yet confirmed, a recent

[11] Financial Conduct Authority, 'FCA Handbook' COBS 1.1 General application, Financial Conduct Authority <https://www.handbook.fca.org.uk/handbook/COBS/1/?view=chapter> [Accessed 21 February 2023].
[12] The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, The Stationery Office <https://www.legislation.gov.uk/uksi/2018/988/regulation/4> [Accessed 21 February 2023].
[13] The Occupational Pension Schemes (Investment) Regulations 2005, The Stationary Office <https://www.legislation.gov.uk/uksi/2005/3378/contents/made> [Accessed 21 February 2023].

consultation suggests all Local Government Pension Scheme (LGPS) funds will fall into the scope of new legislation from the Autumn of 2023. LGPS pools fall within new FCA requirements that come into force in 2022.

- In 2021 the Government announced a plan for mandatory ‘Net Zero Transition Plans.’ The Transition Plan Taskforce published its draft Disclosure Framework and accompanying Implementation Guidance, which were open for public consultation through February 2023.

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 should apply to more than just large listed companies. However, when it comes to judging the behaviour of smaller and medium companies, investors should be mindful of the individual circumstances of the businesses, reflecting upon their 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. However, it is important than any non-compliance is accompanied by 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 mitigating long-term risks to the company's financial sustainability. This should include ESG 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 the UK Corporate Governance 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 to 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, sharing material insights and providing a reasonable basis for assurance.

A HOLISTIC APPROACH TO STEWARDSHIP

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 companies and investors.

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

- Working through the scheme's investment strategy, policy and objectives
- Developing and agreeing upon 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 up key issues for investor consideration 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 consider the following policies, compiled using the PLSA and The Investment Association's 2022 recommendations.[14]

OVERALL POLICY AND APPROACH

- Be clear about how stewardship fits within a company's investment strategy, policy and investment objectives. This should include:

[14] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

  - A clear and agreed upon understanding of the trustee board and the relevant organisations' (e.g. the employers') overall mission, purpose and objectives.
  - A defined set of agreed upon 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. This should include an assessment of culture and values, placing greater value on stewardship alignment in the selection process, an assessment of stewardship incorporation in the whole investment process and an assessment of asset managers capacity to meet evolving expectations.
- Work with advisers to consider the level of resources available for stewardship activities, which assets are covered and what an appropriate structure may be. Some schemes have the resources 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 ESG 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 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 the primary 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.
- Outline a clear plan regarding 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 several 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 for this type 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 deliver effective integration of their stewardship policy objectives as well as 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 to a schedule for monitoring and reviewing outsourced stewardship activities. Working with advisers, scheme investors should consider how frequently and in what 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 Stewardship Code sets out important principles for the role of institutional investors in monitoring and improving standards of corporate governance, as well as the consideration of environmental and social issues in the UK. Asset owner signatories to the Stewardship 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 to a policy and approach for the communication of stewardship activities to stakeholders. This should include communication with regulators and members. Disclosure is required in schemes' SIPs and Implementation Statements and in TCFD reports where relevant. Schemes could also consider including this information in the annual DC Chair's statement or in a standalone Stewardship or Responsible Investment Report, both of which may include additional information on members' annual benefits.

COLLABORATIVE ENGAGEMENT

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

The 2012 Kay Review[15] noted that greater collective engagement could address concerns about the fragmented and disparate ownership of companies, giving investors a greater voice. The PLSA believes that collaborative engagement can be helpful for asset owners to make the most of limited stewardship resources or AUM.

There are several different activities or tactics that investors can use collectively to ensure effective engagement, including: informal discussions with investors or companies; private or public letters; specific engagements with a company; or a formal agreement or initiative (including specific objectives, timescales, and strategies).

The PLSA continues to run and join collaborative engagement initiatives on issues of clear concern to members. Effective collaborative engagement for scheme investors has clear, well-targeted and time-specific objectives that are explicitly linked to improving and protecting the value of scheme members' savings. It will also set out clear legal boundaries and the delineation of responsibilities for those leading or participating.

Schemes should ask their advisers and asset managers at both selection and review sessions what collaborative engagement activities they have taken part in, including their objectives, impact, outcomes and what role they have played. Collaborative relationships between asset managers and investors should be built on a long-term basis and in a such way that they can evolve over time, so they can follow the long-term nature of pension scheme investments. This approach will be key in addressing systemic risks including sustainability challenges.[16]

PLSA ENGAGEMENT CHECKLIST

It is clear that stewardship is about more than just voting, but also engagement. 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

[15] Professor John Kay, 'The Kay Review Of UK Equity Markets And Long-Term Decision Making' Department for Business, Innovation & Skills (2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> [Accessed 21 February 2023].

[16] Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen,'How Do Companies Report On Their 'Most Important Asset'?' Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

an investor's stewardship responsibilities. To ensure an effective engagement strategy that results in purposeful dialogue, investors should:

- 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 employers, 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 to 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 these are not already a part of the engagement process.
    - Some schemes will have the resources to engage but 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 over 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 on whom decisions on both investment and voting rest.
- Work to ensure companies genuinely feel that there is scope for explanations as well as compliance with the Principles of the Corporate Governance Code and other requirements. Where the views of boards and their shareholders differ on matters of corporate governance, constructive discussion should follow. However, schemes should ultimately 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

According to a PLSA and The Investment Association report on sustainable value creation, best practices should include: [17]

[17] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

- Take time to understand a service provider's 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. This should cover the entirety of the investment process and the different asset classes in which they invest.
- Explicitly set out expectations for outsourced engagement activities in legal documents. Schemes should ensure expectations are clearly set out in documents such as the IMA or a 'Governing Charter'.
- Agree to a schedule for monitoring and reviewing outsourced engagement activities. This should align with the performance review cycle, investment and stewardship objectives and Key Performance Indicators (KPIs), while including quantitative and qualitative reporting.

OTHER

- Consider taking part in collaborative engagement initiatives. Combining a scheme's voice with those of others across 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.

THE ROLE OF VOTING IN GOOD STEWARDSHIP

How an investor casts its vote at a company 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

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 beginning of the Covid-19 pandemic in 2020, virtual AGMs have ensured that shareholder participation can continue throughout times of physical restrictions. The PLSA recognises the use of virtual meetings in exceptional circumstances, such as when government restrictions on movement are in place. However, beyond such times, we believe that meetings should allow for in person attendance and should not be held on a 'virtual only' basis. We believe that this fundamentally erodes the ability of shareholders to hold boards to account, and thus would not support this as a permanent arrangement.

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 possible after the meeting and should include in this 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 this 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 those concerns.

- 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 Stewardship 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.

PLSA INVESTOR VOTING CHECKLIST

There are several steps that investors can take to ensure they use their vote to wield maximum influence. These include to:

- 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 considered when deciding how to cast their vote. 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, giving full access to 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 appointment or reappointment of Auditors, attending 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 the scheme's key financial considerations and 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 ESG criteria have been applied in voting decisions.
- Outline 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 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 (including 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, which includes 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 of securities lending and balance this against the likely rewards.

Scheme investors' expectations of their asset managers and custodians regarding securities lending should be set out clearly in relevant legal documents like the IMA. Details covered should include under what circumstances a manager will recall stock (as well as the timescales for this) 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 has exercised its influence through votes to impact 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 alignment 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 address any concerns with their asset managers 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 managers are not sufficiently aligned.

THE PLSA VOTING GUIDELINES

Our Guidelines aim to support scheme investors, their asset managers and proxy voting agents in forming judgements on the resolutions presented 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 voting agents will be taking on their behalf, ultimately 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 Corporate Governance Code, as well as the extent to which investors' expectations have not been met (or previously raised concerns not addressed). This should include consideration of particular circumstances and take place, ideally, after a meaningful engagement process (either individually or collaboratively) that gives sufficient time for the company to respond.

Under UK law,[18] 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

[18] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents> [Accessed 21 February 2023].

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 as necessary.

Shareholders should consider supporting proposals that will protect or further enhance shareholder rights and transparency and which aim to improve 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, Workforce, 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 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 2018 UK Corporate Governance 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[19] shows that investors continue to express high levels of significant dissent on remuneration-related votes (i.e. the Remuneration Policy or Report), and that 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 beneficiaries' best interests. This includes acting as a good steward of the assets entrusted to them. An important part of this is exercising voting rights to send 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 on how they expect their vote should be cast, including against individual Directors.

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

[19] Pensions and Lifetime Savings Association 'PLSA AGM Voting Review', Pensions and Lifetime Savings Association (2019) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2019/AGM%20report%202019_FINAL.pdf> [Accessed 2 March 2023].

USING ASSET MANAGERS AND ADVISERS

We are aware that most schemes will outsource their voting activities to their asset managers or to a proxy voting agent. In turn, many managers will rely on proxy service providers or other voting research services. The number of intermediaries involved makes it particularly important for schemes to 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 fail 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. Where possible, schemes should set out their 'expression of wish' on how they expect managers to execute votes on their behalf.

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 further into the adviser's research and recommendations on key issues or companies.

Please note that schemes should closely consider the areas where an asset 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 the disclosure of voting – including instances where votes cast are contrary to 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 the 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

The beginning of the Covid-19 pandemic in 2020 ushered in a new era of how we look at company culture and the treatment of workforces.

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 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 key questions. The PLSA has undertaken work[20] to determine the value of an engaged, motivated and skilled workforce through a range of proxy metrics (tailored to specific sectors). The aim is for investors to use this to assess its company culture through different sources of information, including their communications with employees, shareholders and wider stakeholders.

EVIDENCE BASE

Shareholders will naturally look at financial results and wider evidence that the Chair and the board 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 within a workplace's culture and processes.

To ensure a strong and inclusive workplace culture, 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 significance to a company's long-term performance – and how this is linked to the firm's culture and purpose.

[20] Pensions and Lifetime Savings Association 'Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds', Pensions and Lifetime Savings Association (2016) <https://www.plsa.co.uk/portals/0/Documents/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.pdf>.

The Annual Report should have clear information on workforce engagement as well as draw clear links between any employee survey findings, actions undertaken in response to this and the expected impact. Key measures include employee turnover and employee survey follow-up. Additionally, a company's Strategic Report should clearly articulate how its 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, desirable outcomes for the company and its stakeholders should be measurable, incentivised, and integrated into remuneration arrangements, with appropriate outcome measures over a reasonable time horizon.

Shareholders may want to undertake a closer analysis of the narrative within company statements, noting the tenor and language used in describing the approach to the workforce and stakeholders. In addition, this analysis should consider whether messaging from the Chair and Chief Executive (CEO) statements are clear regarding 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 and therefore, should be enhanced by shareholder engagement that is central 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 in which a company operates. Investors should look for reliable and consistent sources of data, which allow comparison with others in the sector over time.

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 that is consistent with the company's purpose and values.
- There is a clear link between good performance, the effectiveness of the board and results that are consistent with the company's stated strategy. Any weakness in performance should be adequately explained and addressed and should not be the result of imprudent management, poor judgement or weakness in corporate governance. Any weakness in performance should, rather, owe to external factors over which the board has limited control, but which it is taking steps to combat, nonetheless.
- Boards demonstrate awareness of their s.127 Duties under the 2006 Companies Act.[21] This is a requirement for Directors to have regard to other stakeholders, including workers, customers, suppliers as well as the wider society and environment. This should include evidence of a plan for engagement with stakeholders, as well as activities undertaken and consequent outcomes.

[21] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents> [Accessed 21 February 2023].

- Boards demonstrate positive relationships with key stakeholders. Boards should be able to communicate how stakeholder perspectives are fed into boardroom considerations. This should include shareholders and the quality of this dialogue is vital for assessing culture especially.
- The Annual Report 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 Corporate Governance Code explicitly clarified a 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 corporate governance regime. The Chair should be accessible, accept legitimate shareholder requests for meetings and convey relevant sentiments and dialogue back to the Board.

HOW INVESTORS SHOULD CONSIDER VOTING

The most appropriate route for voicing general concerns is through voting on the Annual Report and Accounts. Investors should consider **voting against adoption of a company's 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 engage and support 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** if:

- The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason as to why or has failed to find a mutually convenient time without undue delay.
- The Chair has repeatedly failed to address investors' concerns about the relationship between the company and 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 THE 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. An important element of this is holding company management – including the CEO – to account.

Separation of the roles of the Chair – who should be transparently independent – and the CEO 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.

BOARD DIRECTOR COMMITMENT

The board 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.

BOARD DIRECTORS 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 board Directors' conduct, including holding management to account when necessary.
- Confirmation that independence (not just performance) was assessed in the board evaluation.

EVIDENCE BASE

Engagement with board Directors, particularly the Chair, gives investors the opportunity to assess the quality and effectiveness of the board overall. A company's Annual Report is a key resource for investors to consider, as it provides important information regarding the division of responsibilities of the board.

The Annual Report should contain details of current leadership appointments, including any changes over the previous year. Investors should be mindful of the separation of the roles of Chair and CEO, as well as the other commitments and interests that board Directors' may have in forming their views. What is more, investors should consider board Directors' concurrent directorships and take account of the size and scope of these outside companies, as well as whether an individual board 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 and 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 within the board work together collectively and effectively. The quality and mix of individuals should give investors reassurance as to the substance 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 any redundancy within these roles should be set out. Similarly, a company's CEO 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.
- The Chair is transparently independent, 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 upon appointment, the company should consult its investors and provide a detailed explanation as to why it considers the appointment desirable and appropriate. In assessing the new Chair's suitability, shareholders must consider:
  - Their calibre, including skills, knowledge and experience
  - The current balance and diversity 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 can 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 can 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, especially where a company is both complex and global in scale or where it operates in a highly regulated sector (such as financial services).
  - 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.
- Clear mechanisms in place for shareholder communication. This must include the appointment of a Senior Independent Director as a key contact for shareholders when the normal channels of the Chair, CEO, or Chief Financial Officer have failed to address concerns or are not the appropriate contact.
- Shareholders are given timely access to online terms and conditions by which Directors are appointed.
- 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 relationships between the Independent Non-Executives and the company. The 2018 Corporate Governance 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 a company's engagement with its 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 CEO/Chair given the pivotal role that a CEO 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 CEO/Chair.

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 CEO without a convincing explanation as to why, where an 'interim' period extends for more than one year or where there is evidence of poor succession planning.
- Investors judge that the arguments presented to justify the succession of the CEO to Chair are insufficient. It is important to note that complexity of the business is unlikely to be sufficient explanation in itself.
- 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 of a combined role persists and there remains serious concern 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) when issues persist.

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 there is evidence of progress on UK boards regarding gender and ethnic diversity, more work remains to be done. Investors must continue to press companies to maintain momentum, set clear timescales, and assess company disclosures on diversity carefully.

The FTSE Women Leaders Review,[22] which sets recommendations for Britain's largest companies to improve the representation of women on boards and in leadership positions, and carries on the work from the Hampton-Alexander and Davies Reviews, recently found that women's representation on FTSE 100 Boards increased from 39.1% to 40.5% between 2021 and 2022 and from 36.8% to 40.1% for FTSE 250 Boards during that same time. Great progress was made by FTSE 350 Boards, which reached the 40% goal for women on boards three years ahead of the target date of 2025. Progress is still needed on other objectives, such as women occupying at least one of four roles of Chair, Senior Independent Director, CEO and Chief Financial Officer, with 43 of the FTSE 100 companies meeting this target.

According to the latest March 2023 report from the Parker Review[23] on the ethnic diversity of UK boards, a key target was nearly met, with almost each FTSE 100 Board having at least one Director from a minority ethnic group by the end of 2022. In the FTSE 250, progress is also being made towards the 2024 target, with 67% of companies that responded meeting the target in 2022, up from 55% last year. Two new targets were also set for December 2027, with each FTSE 350 company being asked to set a percentage target for senior management positions that will be occupied by ethnic minority executives, and 50 of the UK's largest private companies have been set the target of having at least one ethnic minority director on the main board.

SUCCESSION AND BOARD EVALUATION

Continuous board refreshment and succession planning are vital to ensure diversity on boards. It is critical that appropriate and sufficiently flexible succession plans are in place for the CEO and Chair.

An effective board evaluation process will use an independent external facilitator at least every three years.

[22] FTSE Women Leaders 'FTSE Women Leaders Review: Achieving Gender Balance', FTSE Women Leaders (2023), <https://ftsewomenleaders.com/wp-content/uploads/2023/02/2022-ftse-women-leaders-review-final-report.pdf> [Accessed 2 March 2023].

[23] David Taylor & The Parker Review Committee 'Improving the Ethnic Diversity of UK Business: An update report from the Parker Review' (2023) <https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/topics/diversity/ey-parker-review-report-2022.pdf>.

EVIDENCE BASE

While it is particularly difficult to obtain concrete metrics in this area, investors should look for progress over time and evidence that the company's approach is improving diversity.

Company disclosures on succession planning tend to use boilerplate reporting. Investors should look at the Annual Report with an eye towards 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
- Disclosure regarding the diversity of the board on a "comply or explain basis," including a clearly defined process for developing board diversity. A clear discussion regarding 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 its optimal composition and a structured plan and timescales to achieve this. This should include: the ideal mix of experience and skills; gender, ethnicity and other forms of diversity including but not limited to those protected characteristics detailed in the Equality Act 2010;[24] and the proportion of the board that should consist of Non-Executive Directors.
- 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 or obstacles/delays to achieving diversity goals
    - 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. 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.

[24] Equality Act 2010, The Stationary Office <https://www.legislation.gov.uk/ukpga/2010/15/section/4> [Accessed 22 February 2023].

- A clear and convincing rationale for board Director re-election in the Annual Report. Such a statement should present shareholders with a full picture of the relevant and diverse 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, including how their unique background helps shape a diverse board
  - Confirmation that the Director has recently been subject to formal performance evaluation in relation to the fulfilment of their S.172 duties.[25]
- 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 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 and inclusion, including gender, ethnicity and other forms of diversity, 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 and inclusion, including professional, international, and protected characteristics[26] such as:
  - Sex
  - Race
  - Disability
  - Age

[25] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/172/2011-04-22> [Accessed 2 March 2023].
[26] Equality Act 2010, The Stationary Office <https://www.legislation.gov.uk/ukpga/2010/15/section/4> [Accessed 22 February 2023].

  - Sexual orientation
  - Gender reassignment
  - Marriage and civil partnership
  - Pregnancy and maternity
  - Religion or belief.
- And other non-protected characteristics are also considered such as:
  - Socio-economic background
  - Neurodiversity
  - Veterans
  - Returners to workplace.
- Clear, measurable objectives that it has set for implementing its diversity 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. There should be a consistency in the company's strategy towards, and explanations of the contribution of diversity and its link to corporate value over time. This should include:
  - Documentation of the gender and ethnic diversity of the board as well as its progress towards meeting minimum gender and ethnic standards as required by the FCA on all UK listed companies[27] on a comply or explain basis. These are:
    - Gender
      - At least 40 % of the board are women (including those self-identifying as women).
      - At least one of the senior board positions (Chair, CEO, Senior Independent Director , or Chief Finacial Officer) is a woman (including those self-identifying as women).
      - Note: The FTSE Women Leaders Review maintains both these standards and includes additional recommendations on ways to improve gender diversity. We strongly support working towards these additional metrics.
    - Ethnicity
      - At least one member of the board is from a non-White ethnic minority background (as referenced in categories recommended by the Office for National Statistics).
        - Note: The Parker Review maintains this equivalent standard with additional recommendations for improving ethnic diversity, and we recommend using this as a guide as well. Also, it is important to document whether they are a signatory to the Race at Work Charter (or equivalent).

[27] Financial Conduct Authority 'Diversity and inclusion on company boards and executive management', Financial Conduct Authority (2022) <https://www.fca.org.uk/publication/policy/ps22-3.pdf>.

  - Documentation on the board's efforts towards creating an inclusive workplace environment for those with disabilities. This could include whether they are a Disability Confident employer in the UK.
- 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[28]) 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 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 based on our above recommendations of what good company behaviour should be.

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

[28] Financial Conduct Authority, 'FCA Handbook' LR 6.1 Application, Financial Conduct Authority <https://www.handbook.fca.org.uk/handbook/LR/6/1.html?date=2016-03-07> [Accessed 2 March 2023].

- Practice does not improve regarding the composition and succession 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 a failure to disclose a reassuring succession plan, even after engagement with shareholders.
- The board is consistently failing to move closer to the latest FCA requirements on diversity and inclusion – or did not successfully explain the reason for non-compliance – the FTSE Women Leaders Review on gender diversity and the Parker Review recommendations on ethnic diversity.
- The board has not established a diversity and inclusion policy and strategy.
- The board is consistently failing to, or showing lack of effort to, move closer to our above recommendations of what good company behaviour should be regarding board 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 Non-Executive Director 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.
- 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).
- There is no clear evidence that diversity is being sufficiently considered by the board, or where previously committed timescales are not being met, in the senior board positions.

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.

In 2021, the UK Government launched a major consultation on audit reform,[29] bringing together the recommendations of the Kingman Review,[30] the Competition and Markets Authority statutory audit market study,[31] and the Brydon Review.[32] Though the Government has now committed, in the 2022 Queen's Speech,[33] to bring forward an Audit Reform Bill, at the time of writing no timetable for this has been confirmed.

Recommendations from the Brydon Review, that investors may wish to consider, include:

- 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 an Auditor to 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 EXTERNAL AUDITOR

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

[29] Department for Business, Energy and Industrial Strategy 'Restoring trust in audit and corporate governance – Consultation on the government's proposals', Department for Business, Energy and Industrial Strategy (2021) <Restoring trust in audit and corporate governance (publishing.service.gov.uk)>.

[30] Sir John Kingman 'Independent Review of the Financial Reporting Council', Department for Business and Trade, Financial Reporting Council and Department for Business, Energy & Industrial Strategy (2018) <Independent Review of the Financial Reporting Council (publishing.service.gov.uk)>.

[31] Department for Business, Energy & Industrial Strategy 'Market study on statutory audit services: summary of responses', Department for Business, Energy & Industrial Strategy <Market study on statutory audit services: summary of responses to the 2019 consultation (publishing.service.gov.uk)>.

[32] Sir Donald Brydon 'Assess, assure and inform: improving audit quality and effectiveness – final report of the independent review', Department for Business and Trade and Department for Business, Energy & Industrial Strategy (2019) <Independent Review into the Quality and Effectiveness of Audit (publishing.service.gov.uk)>.

[33] Prime Minister's Office 'The Queen's Speech 2022', Prime Minister's Office (2022) <Lobby Pack (10 May 2022) (publishing.service.gov.uk)>.

RISK AND INTERNAL CONTROL

Risk management must be a prominent consideration at any company. In addition to an external audit, an 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 provided by 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 contacts 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 Regulations[34] 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.

[34] The Statutory Auditors and Third Country Auditors Regulations 2016, The Stationary Office <The Statutory Auditors and Third Country Auditors Regulations 2016 (legislation.gov.uk)>.

- 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 AGM 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 ESG 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 expectation that the company will remain a viable and sustainable enterprise for the foreseeable future.
- Directors articulate their reasons for choosing a specific timeframe. 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 appoint or reappoint 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 Annual 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 (for example, they overstate profit or assets or understate likely liabilities such as pension or 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 generally accepted accounting principles accounting numbers if 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 fees 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 the 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 in regards to the sufficient auditing of the company.

SECTION 5: REMUNERATION

The UK is now in the depths of a severe cost-of-living in crisis, which is likely to be impacting the vast majority of those employed in investee companies as well as pension scheme savers.

This is an area of particular focus amongst investors, especially after the introduction of new disclosure requirements by the Companies (Miscellaneous Reporting) Regulations 2018.[35] The legislation established mandatory reporting for some companies on employee and stakeholder engagement, and disclosure of information on the ratios between CEO and average staff pay, among other demands.

According to Minerva Analytics, remuneration and board-related resolutions were the largest sources of shareholder dissent in 2022, accounting for 44.33% and 29.87% of high dissent resolutions, respectively.[36]

Executive Pay

The PLSA has always recognised the importance of appropriate remuneration policies as a litmus test for wider corporate governance practices. We are particularly concerned at some of the executive awards being made, which have historically been significantly out of step with those made to the wider workforce. This is especially concerning in 2023, while inflation reaching a 41-year high of 11.1% in October 2022[37], resulting in financial difficulties for many UK households, including in accessing electricity and gas. The PLSA also believes there is limited evidence that the increase in executive pay over the years has genuinely been in response to performance.

While there is limited data on shareholder dissent on this issue, it remains the case that 'Say on Pay' votes are advisory only. The say on pay legislation was introduced in 2002 and requires publicly traded firms to submit an executive Remuneration Report to a non-binding shareholder vote. According to research from Harvard Business School, there has been no evidence of a change in the level and growth rate of CEO pay after the adoption of the new rules.[38] A second stage in the evolution of the regime began in 2013, when shareholders were granted a binding vote on remuneration policy. Another study stated that in light of the continuing presence of significant levels of excess pay, say on pay has to date had limited success as a regulatory strategy.[39]

[35] The Companies (Miscellaneous Reporting) Regulations 2018, The Stationary Office <https://www.legislation.gov.uk/uksi/2018/860/contents/made> [Accessed 22 February 2023].

[36] Minerva Analytics, 'Minerva Briefing UK 2022 AGM season review' Minerva Analytics (2022).

[37] Office for National Statistics 'Consumer price inflation, UK: October 2022', Office for National Statistics (2022) <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/october2022> [Accessed 24 February 2022].

[38] Fabrizio Ferri and David Maber 'Say on Pay Vote and CEO Compensation: Evidence from the UK', Harvard Business School (2007) <https://www.hbs.edu/faculty/Pages/item.aspx?num=30651> [Accessed 24 February 2023].

[39] B. Wu, Iain MacNeil, Katarzyna Chalaczkiewicz-Ladna "Say on pay' regulations and director remuneration: evidence from the UK in the past two decades', Journal of Corporate Law Studies (2020) <http://eprints.gla.ac.uk/210140/7/210140.pdf> [Accessed 24 February 2023].

Growing anecdotal evidence suggests that companies are not responding to this feedback in a meaningful manner. We are currently engaging the industry in ongoing discussions around a requirement that shareholders be awarded a binding vote and the PLSA is keeping an open mind to supporting such an ask. In the meantime, the PLSA calls on companies to exercise restraint in executive pay, especially during the cost-of-living crisis. The PLSA also encourages investors to evaluate all aspects of a company's remuneration policy, with a view towards ensuring that it is closely aligned with investors' interests, driving long-term strategic success and is in line with wider workforce policies.

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.

We also believe there is growing demand for alignment between remuneration and wider sustainability targets, and we now expect to see this reflected in voting policies.

Gender and Ethnicity Pay Gaps

Companies with over 250 employees are mandated to report on gender pay gap, which is normally included in a separate document alongside their Annual Report.[40] Ethnicity pay gap reporting, however, is not yet compulsory. A 2021 recommendation from the UK Government's Commission on Race and Ethnic Disparities detailed that companies that choose to publish pay gaps between ethnic groups should also publish a diagnosis and action plan to address them.[41] More information on the topic of diversity and inclusion can be found in Section 3: Composition, Succession, and Evaluation.

EVIDENCE BASE

There are often several pages dedicated to executive remuneration in the Annual Report. However, it is vital that companies and shareholders also have regular discussions on strategy and long-term performance; investors must be sure to then 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 wider workforce 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 robust, long-term business rationale as to why a particular approach – such as a

[40] Government Equalities Office, 'Who needs to report their gender pay gap' Government Equalities Office (2020) <https://www.gov.uk/guidance/who-needs-to-report-their-gender-pay-gap> [Accessed 20 February 2023].

[41] Commission on Race and Ethnic Disparities, 'Commission on Race and Ethnic Disparities: The Report' (2021) <Commission on Race and Ethnic Disparities – Commission on Race and Ethnic Disparities: The Report – March 2021 (publishing.service.gov.uk)> [Accessed 26 February 2023].

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 and incentives for Executive Directors should 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 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 the wider society. This should consider taxpayer funded support over the lockdown period and the treatment of the wider workforce.
    - The pay policy should not enable any pay award larger than what is necessary to successfully execute the company's wider strategy and to incentivise and reward appropriately.
    - There are clear time frames for bringing Executive pension contribution rates for existing Directors in 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 environmental and social 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 into consideration (as a starting point) the company's strategic plan and KPIs to ensure there is a strong explanation for the drivers of executive remuneration given the company's overall strategy.
    - This should include a plan in the near-term, if not already undertaken, to tie remuneration to company performance on relevant and material environment and social 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 and 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 well 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 much higher than that available for employees).
  - Consideration should be given for how the company has been impacted by the Covid-19 pandemic, 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 on account of wider factors relating to the company, as well as 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. the value of awards actually paid) may be appropriate in certain circumstances 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 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 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 is given and not accompanied by substantial additional hurdles.
- There are guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments.
- There is any re-testing of performance conditions to enable awards to be made.
- 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 this will be reduced.
- 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 a failure to disclose (or to have a 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 there is 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 fail to 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

Though the cost-of-living crisis has grabbed the headlines in 2022, there is no evidence that investors are reducing their focus on climate change issues. Indeed, the PLSA has noted an increased focus among its members to hold their investment chains accountable to their Net Zero commitments, with a growing expectation of targets and transitions plans.

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.

The pension sector is now required to produce an annual TCFD report,[42] including all schemes with over a £1 billion AUM. The LGPS is likely to have to do this by the end of 2023 as well, but at the time of publication of this document, the industry is still waiting to hear a final decision from the Department for Levelling Up, Housing and Communities (DLUHC). The PLSA therefore expects that companies reference the TCFD in their reports, in order to enable investors to fully assess the extent of their climate risk. We also expect to see evidence of credible transition plans, given the likelihood that this will soon be a mandatory requirement.

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 within trade associations conducting similar activities.

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, prioritising allocation of stewardship resources appropriately.

According to Minerva Analytics, the number of high dissent sustainability resolutions has doubled, from four in the full 2021 year to eight in the first half of 2022. This increase is due to climate-related votes.[43]

Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework, approach and timescales. Nevertheless, their focus on climate reporting should remain the expectation.

[42] Taskforce for Climate-Related Financial Disclosures 'Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures' Taskforce for Climate-Related Financial Disclosures (2017) <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.

[43] Minerva Analytics, 'Minerva Briefing UK 2022 AGM season review' Minerva Analytics (2022).

CLIMATE CHANGE RESOLUTIONS: WHAT SHOULD INVESTORS LOOK FOR?

The last few years have seen a growth in the number of climate-related resolutions being tabled at AGMs. We are also now seeing 'Say on Climate' and other shareholder initiatives resolutions tabled by companies, mainly seeking approval for the climate action plans.

Launched by the hedge fund activist investor Chris Hohn through the Children's Investment Fund Foundation, 'Say on Climate'[44] is a campaign promoting shareholder voting on climate transition action plans. The initiative has been deemed the biggest shake-up of the annual meeting season since the US and UK gave shareholders a vote on executive pay[45] and is now a is now a global movement with shareholder advocates in the U.S., Canada, Europe, Asia, and Australia.[46]

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) where this is in the broader shareholder interest.

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

- 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 certain 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 upon targets and other 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 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 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?

[44] https://sayonclimate.org/
[45] Attracta Mooney, Billy Nauman "Say on Climate' campaign faces first big test at investor meetings', Financial Times (2021) <https://www.ft.com/content/cc409667-e048-4246-808c-9cdf8e41ac77> [Accessed 2 March 2023].
[46] https://www.asyousow.org/our-work/energy/say-on-climate

- 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)?
- For say on climate and other shareholder voting resolutions, investors should consider whether the plans put forward for approval are underpinned by credible targets. Ideally plans should reflect an established industry frameworks and be in keeping with the UK Transition Plan Taskforce (TPT) guidance.[47]

EVIDENCE BASE

The PLSA believes that pension schemes should have access to as much information as possible – (including metrics and climate scenario testing) to enable them to invest well. It is mandatory for listed companies to measure and report on the greenhouse gas emissions that 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. This should therefore be accompanied by a clear narrative surrounding the approach that the company is taking to ensure it manages this risk through its governance, processes and internal control arrangements.

Investors may prefer that companies take a joined-up, industry wide approach to 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, such as the reactions of 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 of 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 the 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

[47] Transition Plan Taskforce 'Consultation The Transition Plan Taskforce Implementation Guidance', Transition Plan Taskforce (2022) <https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Implementation-Guidance-1.pdf> [Accessed 2 March 2023].

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 sufficient disclosures on climate change. Companies should be referencing the TCFD framework in disclosures. 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 the expected physical impacts of climate change are actively considered and discussed in reporting. 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 their 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 to and use of credible industry climate reporting metrics in the Annual Report and Accounts. This should include reference to the TCFD, Sustainability Accounting Standards Board (SASB),[48] Climate Disclosures Standards Board (CDSB),[49] 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 that 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 the UK's Net Zero goal. Companies should disclose whether they have assessed if 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 should include Scope 1, 2 and (where relevant) Scope 3 greenhouse gas (GHG) emissions.[50]
- Credible transition plans set out clear interim targets and milestones, material actions, activities and accountability mechanisms.
- 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

[48] Sustainability Accounting Standards Board 'SABS Standards', Sustainability Accounting Standards Board <Download SASB Standards - SASB>.
[49] Climate Disclosure Standards Board 'CDSB Framework for reporting environmental & social information', Climate Disclosure Standards Board (2022) <cdsb-framework-2022.pdf (ifrs.org)>.
[50] Greenhouse Gas Protocol <Greenhouse Gas Protocol | (ghgprotocol.org)>.

challenge the calculations and/or substitute alternative assumptions in their own financial analysis, should there be concern that these may be dependent 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 its membership within 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.
- Companies take into consideration social factors in all of its activities, including the products and services they offer. Businesses should ensure that their products and services do not pose safety risks, and/or minimize the exposure to geopolitical conflicts in their supply chains. Companies should also consider wider social considerations in relation to future demographic or consumer changes and how these relate to their products and services.

HOW INVESTORS SHOULD CONSIDER VOTING

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

- There is insufficient disclosure 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 Director or the re-election of the Chair if:

- Shareholders have attempted to engage on the issue and 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 not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDSB, 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 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 passed or not.

Investors should consider voting in favour of relevant climate-related or similar resolutions – including Say on Climate resolutions – by making assessments on a case-by-case basis.

SECTION 7. WORKFORCE

A company's workforce is one of the main contributors to its long-term success, with clear and significant reporting being in the best interest of organisations. Investors will value the disclosure of this information, especially when companies recognise the risk poor employment practices can pose and include people matters as a key element of their strategy.

As pension schemes turn their attention to the "S" and "G" of ESG, workforce issues are at the forefront of social factors stewardship policies. Asset owners are rightfully engaging with investee companies in relation to occupational health and wellbeing – with mental health becoming an even hotter topic after the Covid-19 pandemic – alongside checking on improvements in their inclusion and diversity policies, while also not forgetting issues surrounding human rights.

WELLBEING

Wellbeing at the workplace relates to all aspects of the working life, from the quality and safety of the physical environment, to how workers feel about their work and their working environment. According to the International Labour Organization, the goal of workplace wellbeing measures is to complement occupational safety and health measures and to make sure workers are safe, healthy, satisfied and engaged at work.[51]

Physical health

Under health and safety law, all workers are entitled to work in environments where risks to their health and safety are properly controlled, with employers having the primary responsibility for this.

According to the Health and Safety Executive, companies have duties under law to assess risks in the workplace, which includes identifying work activities that could cause injury or illness and taking action to eliminate the hazard, or if this is not possible, control this risk. Employers must also give information about the risks in the workplace and how staff is protected and consult with employees on health and safety issues. Companies also have a legal duty the Health and Safety Information for Employees Regulations to provide health and safety information.[52]

Recent studies from the World Health Organization and the International Labour Organization have shown a correlation between working long hours and increasing deaths from heart disease and stroke.[53] Research published in 2011 estimated that, in 2016, 398 000 people died from stroke and 347 000 from heart disease as a result of having worked at least 55 hours a week.

[51] International Labour Organization <https://www.ilo.org/safework/areasofwork/workplace-health-promotion-and-well-being/WCMS_118396/lang--en/index.htm>.
[52] Health and Safety Executive <https://www.hse.gov.uk/workers/employers.htm>.
[53] World Health Organization & International Labour Organization 'Long working hours increasing deaths from heart disease and stroke: WHO, ILO' World Health Organization & International Labour Organization (2021) >.https://www.who.int/news/item/17-05-2021-long-working-hours-increasing-deaths-from-heart-disease-and-stroke-who-ilo>.

Recently, more attention has been paid to corporate employment practices, especially in the areas of physical health and safety, mental health and sick pay entitlements, due to the Covid-19 pandemic.

HUMAN RIGHTS AND MODERN SLAVERY

Although modern slavery is not yet defined in international law, it is described as a crime and a violation of fundamental human rights. The UK government states it can take many forms including the trafficking of people, forced labour, servitude and slavery. It is a global problem that interlinks with age, gender and ethnicity.[54] It is not an issue confined to history or an issue that only exists in certain countries.[55]

It is estimated that 49.6 million people were living in modern slavery in 2021, of which 27.6 million were in forced labour and 22 million in forced marriage.[56] Of the 27.6 million people in forced labour, 17.3 million are exploited in the private sector; 6.3 million in forced commercial sexual exploitation, and 3.9 million in forced labour imposed by state.

There have been several initiatives from governments to prevent modern slavery. In the UK, the Modern Slavery Act 2015 contains a section which requires commercial organisations – which are a body corporate or a partnership, carry on a business, supply goods or services and have an annual turnover of £36 million or more – to develop a slavery and human trafficking statement each year. Section 54 dictates the statement is expected to set out what steps companies have taken to ensure modern slavery is not taking place in their business or supply chains.

However, an independent review of the act,[57] commissioned by the government and published in 2019, concluded although the new requirement contributed to raising awareness of these issues and has encouraged many companies to start considering and addressing it, its impact has been limited to date. Evidence gathered by the reviewers showed that a lack of enforcement and penalties, as well as confusion surrounding reporting obligations, resulted in poor-quality statements and an estimated lack of compliance from over a third of eligible firms.

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[54] Genevieve LeBaron, Neil Howard, Cameron Thibos and Penelope Kyritsis 'Confronting root causes: forced labour in global supply chains', openDemocracy and Sheffield Political Economy Research Institute (SPERI), University of Sheffield (2018) <https://cdn-prod.opendemocracy.net/media/documents/Confronting_Root_Causes_Forced_Labour_In_Global_Supply_Chains.pdf> [Accessed 10 March 2023].

[55] Home Office 'Frequently Asked Questions on Modern Slavery', Home Office <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/638369/What_is_Modern_Slavery_NCA_v1.pdf>.

[56] International Labour Organization 'Global Estimates of Modern Slavery: Forced Labour and Forced Marriage', International Labour Organization (2022) <https://www.ilo.org/global/topics/forced-labour/publications/WCMS_854733/lang--en/index.htm>.

[57] Home Office 'Independent review of the Modern Slavery Act 2015: final report', Home Office (2019) <https://www.gov.uk/government/publications/independent-review-of-the-modern-slavery-act-final-report>.

In 2022, the FRC's review of corporate governance[58] found that overall, while nearly half of companies report on their policies and procedures as they relate to modern slavery, reporting fails to address the effectiveness of these measures. Furthermore, not one company in the FRC sample disclosed that it had found any cases of modern slavery in the reporting year. There were also no reports of finding instances of modern slavery in the businesses supply chain as a result of the modern slavery audits.

In a bid to tackle modern slavery in supply chains, the UK Government published new guidance[59] in February 2023 for commercial and procurement professionals. Although the guidance is aimed at helping Government practitioners to comply with their supply chain obligations, it is expected it will filter through to a much wider group of businesses, and is considered as an example of how the trend towards greater transparency and engagement with supply chains will affect not just those caught directly by new laws in this area.[60] The guidance focuses on four key areas: identifying and managing risks in new procurements, managing risks in existing contracts, action when victims of modern slavery are identified and training.

DIVERSITY AND INCLUSION

Workforce gender and ethnic diversity has been ranking highly in the public and political agenda in recent years, though high-profile reviews set targets for company boards rather than on an employee level.

According to the most recent FTSE Women Leaders Review (the third and successor phase of the former Hampton-Alexander & Davies Reviews), released in February 2023, progress continues to be made in certain regards on gender diversity.

On ethnicity, there has been an increased focus in this area in recent years, most notably since the widespread global protests against racism in 2020 following the death of George Floyd while in US police custody. FTSE100 companies 2021 Annual Reports included disclosures on how these organisations are investing in inclusion and diversity (I&D), mainly focusing on gender and race. Evidence of this investment was provided by 93%,[61] but only 22% of Annual Reports disclosed the workforce ethnic composition.

[58] Financial Reporting Council 'Review of Corporate Governance Reporting', Financial Reporting Council (2022) <https://www.frc.org.uk/getattachment/6a896f6b-8f4a-4a19-8662-f87a269ffce3/Review-of-Corporate-Governance-Reporting_-2022.pdf>.

[59] Cabinet Office 'Update to Tackling Modern Slavery in Government Supply Chains', Cabinet Office (2023) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1135523/PPN_02_23_-_Update_to_Tackling_Modern_Slavery_in_Government_Supply_Chains_2023_-_Guidance.pdf>.

[60] Osborne Clarke 'New guidance issued on tackling modern slavery in UK government supply chains', Osborne Clarke (2023) <https://www.osborneclarke.com/insights/new-guidance-issued-tackling-modern-slavery-uk-government-supply-chains>.

[61] Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen,'How Do Companies Report On Their 'Most Important Asset'?' Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

More information on this topic of diversity and inclusion can be found in Section 3: Composition, Succession and Evaluation, and Section 5: Remuneration discusses the gender pay gap and ethnicity pay gap.

EVIDENCE BASE

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

Investors should look at Annual Reports for information about health, safety and wellbeing initiatives, alongside examples of practices to mitigate risks in this area. A useful proxy for employee mental and physical health is absence rates. High absence rates can point to unhealthy and possibly overworked staff.[62]

Companies with over 250 employees are mandated to report on gender pay gap, which is normally included in a separate document alongside their Annual Report.[63] Ethnicity pay gap reporting, however, is not yet compulsory. A recent recommendation from UK Government's Commission on Race and Ethnic Disparities detailed that companies that choose to publish pay gaps between ethnic groups should also publish a diagnosis and action plan to address them.

On human rights and modern slavery, companies should include their annually updated statement of compliance with the Modern Slavery Act, signed by a company Director and approved by the board, on the homepage of their website, which should be easily accessible. The government also has a modern slavery statement registry[64] which contains documents issued by companies.

When a company does not publish a modern slavery statement – either because they are not obliged by law to do so or because they elect to state they do not take any steps to help prevent slavery and human trafficking in their supply chain – further analysis should be done by investors to understand risks. This includes focusing on their jurisdiction of operations and industry sector to assess if the level of risk of there being incidences is high, medium or low.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Publish a clear commitment to promoting a culture of openness on mental health, with the CEO signalling leadership commitment on this area.

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62 Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence 'Worthwhile Workforce Reporting: Good practice examples from the UK's biggest companies', Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Worthwhile-Workforce-Reporting-Dec-2022.pdf>.

63 Government Equalities Office 'Gender pay gap reporting: guidance for employers', Government Equalities Office (2020) <>.https://www.gov.uk/guidance/who-needs-to-report-their-gender-pay-gap>.

64 <https://modern-slavery-statement-registry.service.gov.uk/>.

- Publish formal objectives aimed at improving workplace mental health. Board members and operational management should have responsibility for mental health initiatives in the company.
- Include health, safety and wellbeing matters in its risk assessment, and detail how the risk will be managed.[65]
- In the context of the Covid-19 pandemic, a health and safety risk assessment should have been carried out if the company has staff entering workplaces.
- The company board sets objectives and targets to improve mental health and reports annually on progress against these goals.
- Publish gender and ethnicity gap reports annually, alongside initiatives to reduce these gaps.
- The board has diversity and inclusion as one of its priorities and has developed a training/awareness programme for at least the senior leadership in this area. Nevertheless, it should be taken into account there is no evidence unconscious bias training can fully eliminate implicit bias, and its ability to effectively change behaviour is limited,[66] so training programmes should be tailored to the needs of each organisation.
- The Modern Slavery Act statement, which is published on the company's website homepage, contains information about not only its policies in this area but also refers to audits and inspections conducted on sites of their suppliers.
- Company has a long-term training plan for employees and contractors on modern slavery if appropriate.
- Follow the Transparency in supply chains guide[67] issued by the Home Office and has appropriate technology to improve transparency on end-to-end supply chain management.

EMERGING AREAS OF INTEREST FOR COMPANIES

Mental health

The health and safety of employees includes mental health as well. While monitoring the physical safety of employees is a more well-established practice, mental health is a newer aspect to workforce wellbeing disclosure that is only beginning to be explored. Similarly to physical health standards, poor mental health can negatively impact corporate cultures and employee performance. The World Health Organisation has stated that poor working environments – including discrimination and inequality, excessive workloads, low job control and job insecurity –

[65] Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence 'Worthwhile Workforce Reporting: Good practice examples from the UK's biggest companies', Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Worthwhile-Workforce-Reporting-Dec-2022.pdf>.

[66] Civil Service HR 'Unconscious bias and diversity training – what the evidence says', Civil Service HR (2020) <https://www.gov.uk/government/publications/unconscious-bias-and-diversity-training-what-the-evidence-says>.

[67] Home Office 'Transparency in supply chains: a practical guide', Home Office (2015) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/649906/Transparency_in_Supply_Chains_A_Practical_Guide_2017.pdf>.

pose a risk to mental health.[68] Due to this, it makes sense for companies to provide data on wellbeing and mental health together with physical accidents and injuries.[69]

The PLSA was involved in the work of two workforce disclosure reports, which delved into the importance of mental health, with the first concluding that since the onset of the Covid-19 pandemic, mental health decline has become more widespread. Reference to employee wellbeing was made by 89% of companies in FTSE100 in 2021, with many acknowledging the negative impact of Covid-19 in employees' welfare. However, only 13% of these company's Annual Reports discussed mental health in relation to health and safety or risk assessments.[70] In the majority of cases, mental health is not being treated with the same seriousness or reporting in detail as physical health. Collecting information on mental health can be more sensitive and challenging to gather, but it is a material issue for all companies. Organisations should find ways to address and issues and sensitivities, so they are able to report on this matter.

Several research studies have shown a correlation between long-working hours and an increase in mental health deterioration. A 2008 study[71] concluded overtime workers of both genders had significantly higher anxiety and depression levels – and higher prevalence of anxiety and depressive disorders – when compared with those working regular working schedules. Another study published in 2019[72] found women's mental health is more affected than men, with increased depressive symptoms independently linked to working extra-long hours for women.

Menopause

With the number of women over 50 in employment increasing in developed countries due to higher life expectancy, menopause has become an important issue when considering workforce wellbeing. Menopause symptoms continue on average for 4 years – but can last up to 12 years – and mostly affect women between 45 and 55 years old.[73]

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68 World Health Organization 'Mental Health at Work factsheet', World Health Organization (2022) <https://www.who.int/news-room/fact-sheets/detail/mental-health-at-work>.

69 Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen,'How Do Companies Report On Their 'Most Important Asset'?' Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

70 Ibid

71 Elisabeth Kleppa, Bjarte Sanne, Grethe S Tell 'Working Overtime is Associated With Anxiety and Depression: The Hordaland Health Study', Journal of occupational and environmental medicine / American College of Occupational and Environmental Medicine (2008) <https://www.researchgate.net/publication/5312376_Working_Overtime_is_Associated_With_Anxiety_and_Depression_The_Hordaland_Health_Study>.

72 Gillian Weston, Afshin Zilanawala, Elizabeth Webb, Livia A Carvalho, Anne McMunn 'Long work hours, weekend working and depressive symptoms in men and women: findings from a UK population-based study', BMJ Journals (2019) <https://jech.bmj.com/content/73/5/465>.

73 Dr Pratima Gupta in collaboration with the medical advisory council of the British Menopause Society 'The Menopause', Women's Health Concern (2022) <https://www.womens-health-concern.org/wp-content/uploads/2022/12/15-WHC-FACTSHEET-The-Menopause-NOV2022-B.pdf>.

Around 30-60% of women experience intermittent physical and/or psychological symptoms during the menopause,[74] and its symptoms can affect the quality of both personal and working life.[75]

A survey published by the UK's Parliamentary Women and Equalities Committee in February 2022 showed 31% of women took time off work due to menopause symptoms, which included problems with memory or concentration, anxiety/depression and headaches. Despite this, less than a third of respondents told anyone at work and just under 11% requested adjustments in the workplace due to their symptoms.

A report published by the same Committee months later concluded the lack of support from employers is pushing women out of work, and there are several movements in developed countries to push for a recognition of menopause as a protected characteristic in workers' rights.

HOW INVESTORS SHOULD CONSIDER VOTING

Investors should start by engaging in these topics and promote best practices which companies should follow.

Investors should expect portfolio companies to focus not just on the physical health and wellbeing of their workers, but on their mental wellbeing as well, and to disclose their approach and activities in this regard. Investee companies should set objectives and targets to monitor and improve mental health where appropriate and report annually on progress against these goals.

Engage with companies on menopause, with a view of encouraging organisations to include menopause issues in its wellbeing strategy and produce an Annual Report on the latter.

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

- FTSE 100 companies do not have a formal approach to workplace wellbeing disclosure, including mental health management and disclosure.
- If after engagement initiatives with companies, there is insufficient progress on wellbeing activities disclosures.
- FTSE 350 companies fail to address the legal minimum requirements of the Modern Slavery Act.

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

- Companies identified as highly exposed to modern slavery risks, or where there have been confirmed incident, fail to demonstrate an adequate risk management and a willingness to change their approach.

[74] Ibid

[75] Department of Health 'Annual Report of the Chief Medical Officer, 2014', Department of Health (2015) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/595439/CMO_annual_report_2014.pdf>.

- Companies do not adopt sufficient measures to prevent, monitor, mitigate or remediate negative human rights impacts within its operations.

SECTION 8: 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 to protect its capital value. It can appear unexciting – and so often receives little attention from investors – but a misjudged approach to this can contribute to corporate collapse and failure.

Capital allocation practices include repayment of debt, repurchasing of shares, paying final or interim dividends to shareholders and investment either in organic growth or in mergers and acquisitions 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. In addition, the appropriate ratios between profitability and dividend payments must be maintained.

Although some of the issues highlighted may seem technical or of low priority, investors should be alert to signs that the company continues to fail to honour shareholder rights. In 2016, BHS went into administration[76] following several corporate governance failures including the 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.[77] For its part, Carillion paid out £376m over a five-year time period while generating £159m of net cash from operations.[78] 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 creditworthiness.

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'[79] and 'Section 570'[80] Authorities.

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[76] Murad Ahmed 'BHS goes into administration after sale talks fail', Financial Times (2016) < https://www.ft.com/content/3f83c690-0aad-11e6-b0f1-61f222853ff3> [Accessed 2 March 2023].

[77] Work and Pensions and Business, Innovation and Skills Committees 'BHS', Work and Pensions and Business, Innovation and Skills Committees (2006) <https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/54.pdf> [Accessed 2 March 2023].

[78] Federico Mor, Lorraine Conway, Djuna Thurley, Lorna Booth 'The collapse of Carillion', House of Commons Library (2018) <https://researchbriefings.files.parliament.uk/documents/CBP-8206/CBP-8206.pdf> [Accessed 2 March 2023].

[79] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/551> [Accessed 21 February 2023].

[80] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/570> [Accessed 21 February 2023].

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 issued 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 are equivalent to 10% of the issued share capital at the time of the authority. An additional 10% is acceptable provided that the company confirms in its AGM 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 twelve-month period.

SHARE BUYBACKS

Takeover Code Rule 9[81] waivers are usually sought when 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 – 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 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

[81] The Panel on Takeovers and Mergers 'The Takeover Code' Thirtheen Edition, The Panel on Takeovers and Mergers (2021) < The-Take-Over_Bookmarked_20.2.23.1.pdf (thetakeoverpanel.org.uk)> [Accessed 2 March 2023].

– 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. In addition, this includes 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 the long-term interest of the shareholder.

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 DRC 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 materially disadvantage 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, 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 to 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[82], except where they can make a clear case for these not being applied in the context of the best interest 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, as well as appropriate procedures to identify and manage conflicts of interest.
- There is a Committee of Independent Directors with the ability to take independent advice that 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 shareholders.

[82] Financial Reporting Council 'Pre-Emption Group Statement of Principles', Financial Reporting Council (2022) <PEG_Statement-of-Principles.pdf (frc.org.uk)> [Accessed 2 March 2023].

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 DRC 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. 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, is 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 that this is a serious issue and if investors have 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 9: TAKING A HOLISTIC APPROACH

It is important for investors to take stock after working 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, which 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. As a reference point, The Investment Association publishes a public register[83] with details of companies which have received significant opposition by shareholders to a resolution.

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. 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

<u>Investors should consider voting against the Annual Report and Accounts</u> if:

- Report has not fulfilled its purpose of giving insight into the company's strategy, vision and business model.

[83] The Investment Association 'Public Register', The Investment Association (2023) <https://www.theia.org/public-register>.

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

- There are particularly serious concerns about the company's business model, plan or the implementation of its plan for engagement with long-term shareholders.
- The company seems unwilling to change its approach despite significant investor concerns.
- The company does not follow corporate governance provisions to respond to dissent.

Please note that 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 Corporate Governance 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 as to why 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 between the company and 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 CEO without a convincing explanation as to why, 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)

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Division of Responsibilities	Investors judge that the arguments presented to justify the succession of the CEO to Chair are insufficient. It is important to note that complexity of the business is unlikely to be sufficient explanation in itself	AGAINST	Chair; Director responsible for the appointment process; (Annual 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	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	The situation of a combined role persists and there remains serious concern 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	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	Investors should consider also voting against the election of the Director responsible for the appointment process (often the SID) when issues persist	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
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 based on our above recommendations of what good company behaviour should be	AGAINST	Annual Report and Accounts
Composition, Succession and Evaluation	Practice does not improve regarding the composition and succession or there is consistently no independent board evaluation conducted	AGAINST	Chair

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Composition, Succession and Evaluation	If: - There is no evaluation process - 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 latest FCA requirements on diversity and inclusion – or did not successfully explain the reason for non-compliance – the FTSE Women Leaders Review on gender diversity and the Parker Review recommendations on ethnic diversity - The board has not established a diversity and inclusion policy and strategy - The board is consistently failing to, or showing lack of effort to, move closer to our above recommendations of what good company behaviour should be regarding board diversity - There is a failure to move to annual Director elections and an absence of an acceptable explanation	AGAINST	Chair; Chair of Nominations Committee

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Composition, Succession and Evaluation	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 Non-Executive Director 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 ▸ 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) ▸ There is no clear evidence that diversity is being sufficiently considered by the board, or where previously committed timescales are not being met, in the senior board positions	AGAINST	Chair; Directors

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Audit, Risk and Internal Control	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 (for example, they overstate profit or assets or understate likely liabilities such as pension or 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 Generally accepted accounting principles accounting numbers if 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	AGAINST	Annual Report and Accounts; Auditor; Audit Committee Chair

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Audit, Risk and Internal Control	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 ▸ 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 the payment of dividends) – and these are not resolved satisfactorily by the board	AGAINST	Audit Committee Chair; Reappointment of Auditor
Audit, Risk and Internal Control	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	AGAINST	Auditor's remuneration; reappointment of Auditor
Audit, Risk and Internal Control	There are extreme concerns or persistently poor disclosure in regards to the sufficient auditing of the company	AGAINST	Chair

Remuneration	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 is given and not accompanied by substantial additional hurdles - There are guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments	AGAINST	Remuneration Policy

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
	• There is any re-testing of performance conditions to enable awards to be made • New share award schemes are layered on top of existing schemes		

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Remuneration	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 this will be reduced - 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 a failure to disclose (or to have a 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 there is 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	AGAINST	Remuneration Report

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Remuneration	If: ▸ The company has repeatedly failed to take investors' concerns into account and fail to 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	AGAINST	Remuneration Committee Chair (if in post for over one year)
Climate Change and Sustainability	If: ▸ There is insufficient disclosure 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	AGAINST	Annual Report and Accounts

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Climate Change and Sustainability	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. These metrics also should not be contradictory	AGAINST	Remuneration Policy

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Climate Change and Sustainability	If: - Shareholders have attempted to engage on the issue and 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 not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDSB, 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 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	AGAINST	Directors; Chair
Climate Change and Sustainability	Investors should also consider voting in favour of relevant climate-related or similar resolutions – including Say on Climate resolutions – by making assessments on a case-by-case basis.	FOR	Shareholder resolution

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Workforce	If: • FTSE 100 companies do not have a formal approach to workplace wellbeing disclosure, including mental health management and disclosure • After engagement initiatives with companies, there is insufficient progress on wellbeing activities disclosures • FTSE 350 companies fail to address the legal minimum requirements of the Modern Slavery Act	AGAINST	Annual Report and Accounts
Workforce	If: • Companies identified as highly exposed to modern slavery risks, or where there have been confirmed incident, fail to demonstrate an adequate risk management and a willingness to change their approach • Companies do not adopt sufficient measures to prevent, monitor, mitigate or remediate negative human rights impacts within its operations	AGAINST	Directors
Capital Structure and Allocation	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 DRC 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	AGAINST	Approval of the final dividend
Capital Structure and Allocation	• Section 551 and Section 570 Resolutions are bundled together. The issuance is not consistent with Pre-Emption Principles without a satisfactory explanation	AGAINST	Issuance of new shares

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Capital Structure and Allocation	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, is not supported by cash flows of the underlying business and introduces excessive and unsustainable leverage	AGAINST	Market purchase of shares
Capital Structure and Allocation	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.	AGAINST	Related party transactions
Capital Structure and Allocation	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 that this is a serious issue and if investors have 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	AGAINST	Chair
Taking a Holistic Approach	Report has not fulfilled its purpose of giving insight into the company's strategy, vision and business model	AGAINST	Annual Report and Accounts

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Taking a Holistic Approach	If: - There are particularly serious concerns about the company's business model, plan or the implementation of its plan for engagement with long-term shareholders - The company seems unwilling to change its despite significant investor concerns - The company does not follow corporate governance provisions to respond to dissent	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 engagement with FTSE 100 companies on workforce disclosure issues undertaken in 2021 by the steering group on workforce disclosures,[84] of which the PLSA was a part – 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

[84] Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence 'Worthwhile Workforce Reporting: Good practice examples from the UK's biggest companies', Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Worthwhile-Workforce-Reporting-Dec-2022.pdf>.

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: 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 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.

https://www.icgn.org/sites/default/files/2022-04/ICGN%20Global%20Governance%20Principles%202021.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.thtml

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

The UK Corporate Governance Code (2018)

https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

The UK Stewardship Code (2020)

https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

OECD Principles

www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm

IVIS Guidelines

www.ivis.co.uk/Guidelines.aspx

GC100 and Investor Group Guidance on Directors' Remuneration Reporting

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

The Report on the Taskforce on Pension Scheme Voting Implementation

https://www.gov.uk/government/publications/taskforce-on-pension-scheme-voting-implementation-recommendations-to-government-regulators-and-industry/the-report-of-the-taskforce-on-pension-scheme-voting-implementation-recommendations-to-government-regulators-and-industry#annex-2-recommendations

Institutional Investors Group on Climate Change

https://www.iigcc.org/

Climate Action 100+

https://www.climateaction100.org/

Financial Reporting Council Corporate Governance and Stewardship mythbuster

https://www.frc.org.uk/getattachment/acbaaca0-11cd-4b10-85e3-0c27208d477f/FRC-CG-S-mythbuster.pdf

PLSA Policy & Research Library

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

The PLSA Voting Reporting Template and Implementation Statements Guidance

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

Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers

https://www.plsa.co.uk/Policy-and-Research/Document-library/Investment-relationships-for-sustainable-value-creation

PLSA Engaging the Engagers: A Practical Toolkit to Help Schemes to Achieve Effective Stewardship Through Their Managers

https://www.plsa.co.uk/Policy-and-Research/Document-library/Engaging-the-engagers-A-practical-toolkit

How Do Companies Report on Their Most Important Asset?

https://www.plsa.co.uk/Policy-and-Research/Document-library/How-do-companies-report-on-their-most-important-asset

Worthwhile Workforce Reporting: Good Practice Examples From the UK's Biggest Companies

https://www.plsa.co.uk/Policy-and-Research/Document-library/Worthwhile-Workforce-Reporting-Dec-2022