2020

AGM SEASON FORECAST

A YEAR OF CLARITY?

CONTENTS

Executive Summary

The ever-changing corporate landscape is making the AGM season a more uncertain time.

In the UK, proxy adviser influence increased significantly, by 3.3% of the issued share capital of the average FTSE Company in just one year. More directors were held to account with higher votes against Remuneration Committee members. Investors became more courageous, voting against large salary increases, high pensions, egregious recruitment packages and LTIPs with adjustments to in-flight targets for share price falls.

In the US, the proportion of directors failing to receive majority support continued to climb and the average level of support for say-on-pay proposals fell from 89% in 2018 to 88%. The number of environmental and social proposals rose slightly, while the overall number of shareholder proposals submitted for a vote was the lowest in five years.

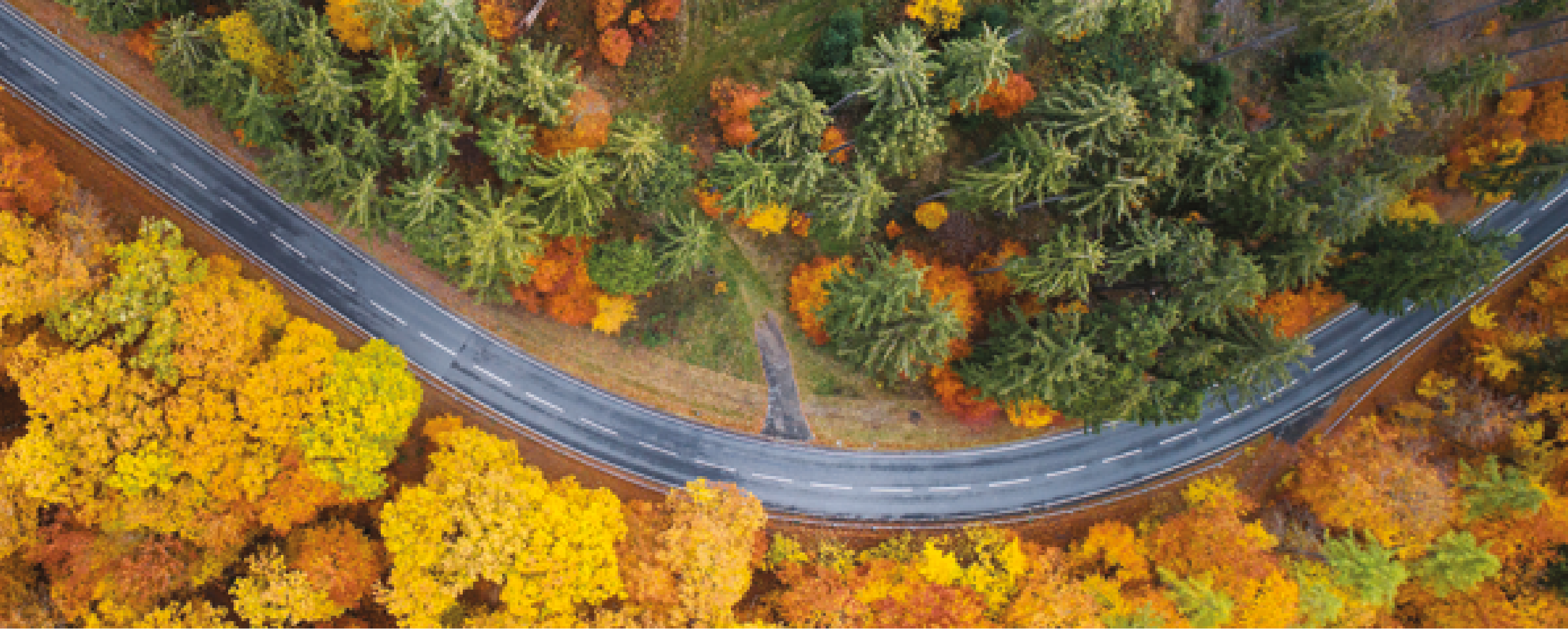
In 2020, we are expecting more developments. Challenges will come from increasingly confident investors and proxy advisers whose expectations are likely to be higher than the new codes and standards. We also predict much discussion about sustainability, thanks to the Section 172 Statement requirement in the UK and diversity, thanks to the Boardroom Accountability Project 3.0 in the US.

To help you prepare for 2020, the key themes we therefore focus on in this report are:

- **Regulatory Impact** What new and updated regulation do you need to be aware of and how can you prepare?
- **Executive Compensation** What are the proxy adviser and investor trends to be aware of when developing your remuneration policy?
- **Environmental, Social and Governance Issues** Why is sustainability continuing to grow in importance and what are the opportunities and risks?
- **Board Accountability** Where are shareholders and proxy firms likely to place pressure on boards?
- **Shareholder Activism** What can 2019 tell us about how likely a shareholder spring is in 2020, and how can you prevent activism at your own AGM?

1. Unless otherwise indicated, all statistics quoted in this report are taken from research undertaken by Equiniti's AGM team. The statistics include all companies in the FTSE 100 and FTSE 250 indices as well as Equiniti clients outside of these indices.

2. According to PwC's ProxyPulse: 2019 proxy season review



Regulatory Impacts

Most countries conduct regular reviews of their corporate governance regulatory frameworks, with many revising their codes every three-to-four years, so what's new for 2020?

UK

1. The new **Section 172(1) Statement** now needs to be written each year in the strategic report element of your annual report. It should highlight how directors have addressed a list of factors including: interests of employees, suppliers and customers; impact on the environment; and the company's reputation when carrying out their duty to promote the success of the company.

Tips for CoSecs

- The actual statement doesn't have to be long – it's how the decisions are made along the way that is important.
- Create an audit trail that shows how the directors are trained to make it second nature to think about the wider impact of decisions on employees, community, suppliers, customers and other stakeholders.
- Ensure there is no siloed writing and all the right people are involved so the statement and the report gel together.

2. **Provision 5 of the UK Corporate Governance Code** has come into force meaning that to understand the views of their workforce, companies need to put in place: an employee director appointed from the workforce; a formal workforce advisory panel; a designated non-executive director (NED); or alternative arrangements.

   We are seeing that most companies are opting for a combination of a NED and a workforce panel to take employee viewpoints to the board. This will likely lead to increased focus on wider employee considerations within executive pay, including salary increases and pensions.

3. For many companies, 2020 is time for a Remuneration Policy review and, for the first time, they will need to consider the **UK Corporate Governance Code provisions 40 & 41, Miscellaneous Reporting Regulations and Remuneration Reporting Regulations 2019.**

   This will involve Remuneration Committees ensuring that clarity, simplicity, risk, predictability, proportionality and alignment to culture are all considered when reviewing their Remuneration Policy. In addition, investors will no doubt pour over the new CEO Pay Ratio figure that has to be included in remuneration reports.

4. In the wake of recent corporate failures, companies will face more rigorous assessment by auditors, following the Financial Conduct Authority's (FCA) publication of the revised **International Standard on Auditing, Going Concern.** Company boards will need to provide an increasing level of factual support for their going concern statements.

5. The revised UK **Stewardship Code 2020 edition**, that the FRC has strengthened, will impact on those asset managers and owners who wish to remain signatories to code. They will need to comply with the code's extended twelve principles, raising expectations for increased transparency around their activities. This could see greater caution and increased pressure from investors subject to the code when assessing their voting positions at company AGMs.

Regulatory Impacts

US

1. By April or May this year, the two new Securities and Exchange Commission (SEC) proposed rule amendments are expected to be approved. **One** will aim to improve the accuracy and transparency of proxy voting advice, and reduce conflicts of interest. The **second** is to amend requirements for shareholders to initially submit, as well as resubmit, shareholder proposals for inclusion in a company's proxy statement.

When they are finalised, both proposed rule changes would be helpful to public companies:

– Proxy advisers would be required to send draft reports to each company they are analysing. If the company disagrees with opinions in the report, a hyperlink will be included in the final report outlining their viewpoint so institutional investors can evaluate both viewpoints before making a voting decision.

– It would become more difficult to file a shareholder proposal as minimum shareholding requirements would be tied to a longer holding period. A tiered approach could be introduced where a proponent's continuous shareholding requirements would need to be either:

- **At least $2,000 worth of company stock for a minimum of three years**
- **Or $15,000 worth of the stock for at least two years**
- **Or $25,000 worth of the stock for at least a year**

– Resubmission thresholds are also proposed to be amended, increasing the level of support a proposal must receive in order to be resubmitted, and allowing companies to exclude the shareholder proposal from resubmission when the level of support has declined, according to the newly proposed levels.

2. In New York, the NYC Comptroller, Scott Stringer, introduced the latest version of the **Boardroom Accountability Project - 3.0** calling on 56 S&P 500 companies to adopt a policy to consider both women and people of colour for every open board seat and for CEO appointments – a version of the "Rooney Rule" pioneered by the National Football League (NFL). Comptroller Stringer may file shareholder proposals at companies with a lack of diversity at the highest levels.

While governance codes are not rules, they need to be understood and either adhered to or full explanations provided for departures from them. Because of their introduction, some investors will revamp their policies and in many cases will go further than the recommendations.

Executive Compensation

It’s the million-dollar question – how do we develop a competitive Compensation Policy to which shareholders can positively react?

UK

In the UK, given the need to gain approval every three years, we predict there will be a significant number of remuneration policy votes during this year’s AGM season as in 2019, only 114 companies put their policy to a vote, compared with 169 companies in 2018 and 268 in 2017.

How are new guidelines expected to influence the status quo in UK companies from a remuneration standpoint? Key issues to consider are:

1. In November 2019, the Investment Association published updated Remuneration principles that request companies reduce executive director pensions to be in line with the wider workforce – This is now expected for both new appointees and incumbent directors.
2. 32 of the FTSE 100 companies operate post-holding periods and that number is expected to increase dramatically with an expectation by investors that such holding period extend to 2 years for the full shareholder requirement. Almost all companies operate malus and clawback features and to show that they are taking softer issues seriously - such as reputational damage failings and risk management - many will widen the range of events that trigger these provisions beyond pure financials.
3. There has been a marked increase in ESG factors and non-financial reporting being considered by investors, both in terms of remuneration structures and risk considerations. Companies can ill afford to ignore these points.
4. Standard LTIPs still make up 95% of all long-term incentive schemes at FTSE 100 companies, with only 5% using Restricted Share Plans. 93% of FTSE 100 LTIPs have three-year performance periods – Will this change now the Investment Association has provided assurances that investors are ready to consider other structures?

Based on what happened in 2019 and the new codes, consider:

- Reducing pension contribution rates for new directors – and for incumbents over time
- Introducing a broader range of annual bonus pay-outs and examples of discretion, so the committee can reduce pay outs if necessary to uphold the reputation of the company
- Disclosing CEO pay ratios and linking pay ratios to employee pay
- Lengthening post-vesting holding periods and provide for post-exit periods to cover the full shareholding requirement over a two-year period

STANDARD LTIPS MAKE UP

95%

OF ALL LONG-TERM INCENTIVE SCHEMES AT FTSE 100

93%

OF FTSE 100 LTIPS HAVE THREE-YEAR PERFORMANCE PERIODS

32 out of 100

COMPANIES OPERATE POST-HOLDING PERIODS

Executive Compensation

US

The executive compensation landscape in the US looks similar to the UK in terms of trends – diversity, ESG and long-term good governance will all play a role in determining if proxy advisers and investors will vote for or against a motion.

We anticipate the usual pay-for-performance considerations to continue to play a major part in say-on-pay voting decisions. Companies will need to disclose short-term and long-term targets, and the percentage of compensation tied to performance. Any increase in pay will be scrutinised and the performance metrics should be clearly outlined.

The vast majority of public companies have an annual advisory vote on their executive compensation programs, under rules established by the Dodd-Frank Act of 2010. Companies receiving low favourable votes, generally due to proxy advisory firms, are likely to face other problematic votes, such as against votes on the company's compensation committee chair, members of the compensation committee, or the entire board.

To help avoid a negative say-on-pay vote recommendation from proxy advisory firms, review compensation practices:

- What portion of pay is base salary?
- What portion is tied to performance?
- Is the performance-tied pay short-term or long-term?
- Is it paid in cash or equities?
- What are the performance metrics?

For the most part, institutional investors and proxy firms still prefer to see pay measured against performance but some of the proposals we have seen request that companies add sustainability and ESG considerations into executive compensation performance measures. Some want companies to amend their performance measures to include wider stakeholder considerations, including employees, diversity or industry specific targets (such as safety records in the construction sector).

Performance measures that include diversity are not as common as a focus on boardroom diversity. At least one female is required on all company boards by ISS and Glass Lewis. As a compensation performance measure, diversity is becoming more common, though it is not required by ISS or Glass Lewis currently. Companies are increasingly using diversity goals as part of compensation performance measures, the idea being that to attain more diversity in a company, a percentage of executive pay needs to be tied to measuring whether there has been an increase in diversity.

How to effectively engage with proxy adviser

1. Actively engage all the relevant proxy advisers, ensuring to contact both the standard research and proxy contest teams of ISS and Glass Lewis.
2. Understand the proxy advisers' policies for judging proxy contests and leverage this understanding during engagement with them.
3. Equal 'airtime' will be given to both the company and the activist, so ensure messaging is more compelling than the other side's.
4. The recommendation reports will generally come out two weeks before the general meeting. Once available, review the reports and identify any inaccuracies and points of contention and raise these with the proxy advisers – proving 'factual' errors can over-turn negative recommendation.
5. Monitor the release of the reports and plan PR around this release.

Environmental Social and Governance Issues

It might be AGM season but the acronym on everyone's lips is "ESG". Boards will likely see previously passive fund giants continue their shift toward more active oversight of their shares, voicing concerns on issues such as environmental impact, workers' rights and supply chain management. As a result, public companies should be proactive in their engagement with all stakeholders at the portfolio manager and governance analyst level across equity, debt, governance and sustainability audiences.

Richard Davies, Founder & Managing Director, RD:IR from Equiniti believes companies should see ESG not just as a challenge but as an opportunity to improve perception and increase traction with current and potential investors:

> Asset managers are voting with their capital in a very directional way due to the increase in importance of sustainability. We have seen a rise in indexation and passive funds, which are more likely to use ESG criteria in terms of their investment and their engagement with companies through voting – and we have seen more money invested into pure ESG funds.
>
> "Companies with good credentials can target these funds as sources of capital, and those that don't take it seriously will have a difficult time achieving a strong performance. The world of investment has woken up to the fact that if you don't have a sustainable company there won't be anything to invest in further down the line."

UK

ESG will remain under the spotlight as it develops further from niche to norm, with the stand-out issues likely to remain remuneration and sustainability.

Under the newly introduced reporting requirements regarding Section 172 of the Companies Act, boards are expected to improve their reporting of these issues and how all company stakeholders are affected. Other developments that ensure ESG continues to be a significant issue are The Department for Business, Energy and Industrial Strategy (BEIS) environmental reporting guidance, under which companies are now required to publish their total energy use and energy action. The recent FCA Feedback Statement on climate change and FRC's report on climate-related corporate reporting are further evidence that the issue is not going away.

However, despite all the pressure, many companies still aren't getting it right…

> [T]here is a gap between the expectations of investors and reporting practice, both in the quality and granularity of information provided. Disclosure is developing, and as investor approaches become more sophisticated and increasingly affect capital allocation decisions, further development will be necessary."

Climate-related corporate reporting: Where to next? Financial Reporting Council

US

In 2019, a new Business Roundtable statement signed by nearly 200 leading businesses outlined a modern standard for corporate responsibility by affirming, "the essential role corporations can play in improving our society when CEOs are truly committed to meeting the needs of all stakeholders". Corporate responsibility is no longer solely to stockholders, but for all stakeholders, including employees and the community at large.

This redefinition is expected to create a groundswell of change, as business strives to create long-term, sustainable value for all.

There has been a convergence of process and approach between ESG issues and traditional financial measurements. The two issues are now working in combination and AGM preparation and shareholder engagement should consider both.

Improve your ESG reporting by addressing:

- How the board consider climate change
- Whether and how your business model is affected by climate change
- The key opportunities and risks, and consequent changes to strategy
- How the company measures any climate-related impact and challenges
- Developing website content disclosing your ESG credentials
- Issuing sustainability reports (and in the US., make sure they include a link to your proxy statement)

Board Accountability

The public face of the board is no longer just the Chair and key executives. In 2020, shareholders will look to hold specific committee chairs to account on issues and place pressure on boards to be more diverse and with shorter or a mix of tenures.

UK

UK board chairs are facing greater shareholder scrutiny and less comprehensive re-election results, with the number of companies where the Chair received 95% approval falling significantly during the last two years.

What was also noticeable in 2019 was the large number of directors standing down and new director elections. This is likely due to two issues: pressures from investors against directors who have served on a board for a long period of time and companies wishing to address board composition and diversity issues.

As a NED or the Chair, 2020 will be tougher given the tighter guidelines. According to Jonathan Harker, Director of Stewardship at Boudicca from Equiniti:

"It will take a lot more effort to retain the status quo, especially related to audit, pensions, the workforce and pay ratios. Chairs are encouraged to engage more regularly and more thoroughly than ever before, demonstrating to what extent they have listened and acted on advice."

US

In 2020, as always, companies can expect an against or withhold vote on a board member, if attendance by that director is less than 75%, and for directors who are considered overboarded. Other issues to look out for this year, including:

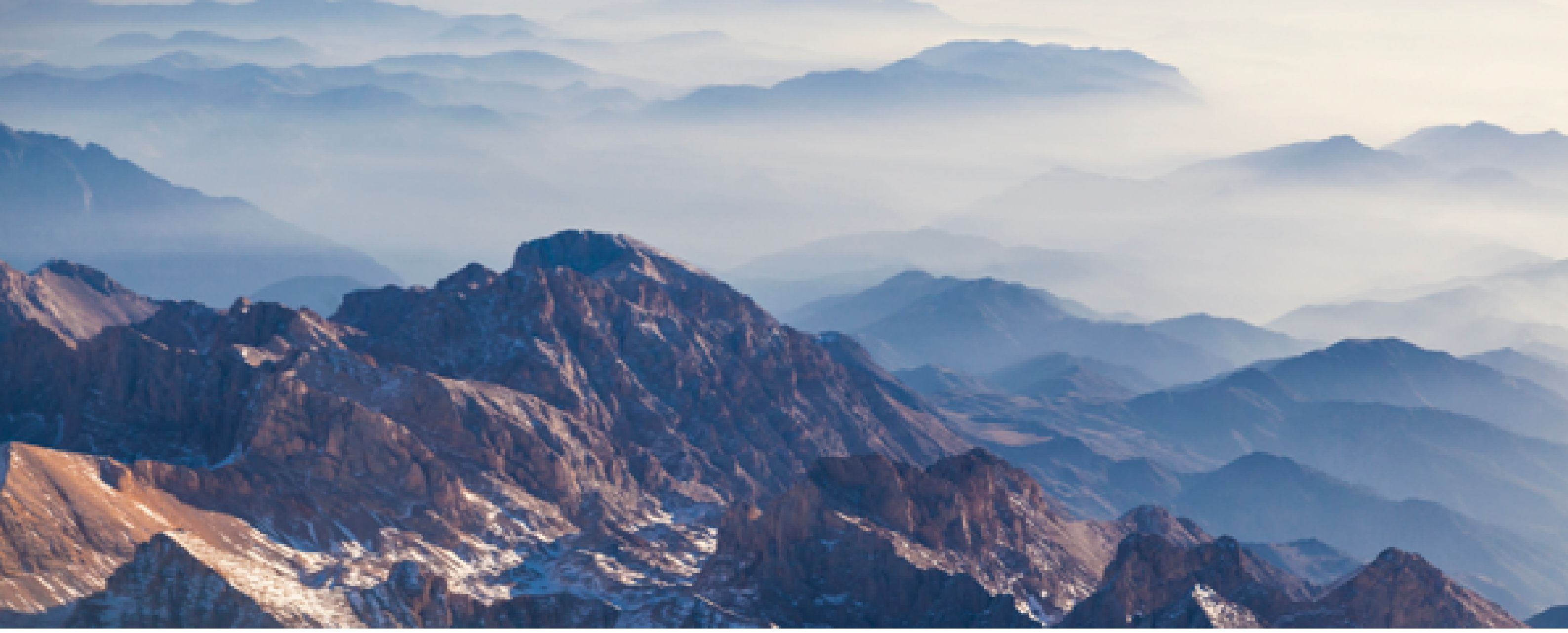
- **Diversity:** ISS and Glass Lewis are looking for at least one woman on the board and BlackRock is looking for two. Companies that have all male boards should look to explain in their proxy statement how they plan to change that.
- **Politics:** As in 2016 when we saw the last presidential election, we are expecting more proposals requesting reports on lobbying and political spending.
- **ESG:** Generally environmental proposals are not being passed but they are getting higher vote results than in the past.

Shareholder proposals which are likely to receive high votes in 2020 are those:

- Electing the full board each year, usually called "Declassify the Board"
- With majority voting standards for directors, usually called Eliminate Supermajority Vote Requirements
- Reducing shareholding requirements to call Special Meeting and Written Consent
- Reporting on Gender Pay Equity
- Including data on the number of employees by job category, gender, race, and ethnicity, under the Annual Disclosure Policy of EEO-1 Data

When it comes to board accountability, be aware of:

- **Skillset** There will be closer interrogation and examination of CVs of those put into new positions. They need to have the knowledge and experience to be able to expertly challenge on behalf of shareholders.
- **Board structure** What is the mix of skills on the board and are they ready for the tasks of the future?
- **Chair tenure** Has the Chair been in place too long?
- **Overboarding** Investors are ready to vote to reduce the number of positions an individual holds, even if it will reduce diversity.
- **Diversity** Investors and proxy advisers each expect a minimum proportion of women on the board. They are looking for a well-rounded board that includes diversity of race, ethnicity, age, background, and sexual orientation (if disclosed).
- **Audit issues** In light of recent issues, how will a high profile controversy be averted?



Shareholder Activism

Activism activity continued to be robust during the 2019 proxy season, although there was an 11% downturn from 2018-19. In the 12-month period ending June 30, almost 600 new campaigns were initiated globally, in addition to the focus some activists gave yet-to-be-resolved campaigns announced in previous proxy seasons.

The UK continued to be the largest target market for activists in Europe with 52 campaigns taking place and a record 147 investors launching new campaigns, including 43 "first timers" with no previous activism history. Indeed, there has been a shift from a few well-known activists to what equity adviser, Lazard, describes as "a more diversified group of occasional agitators and institutional investors".

Large-scale shareholder activism sometimes seeks to oust entire boards, but more commonly takes issue with specific areas:

- Board related (50% of issues raised with companies)
- Auditor issues
- Executive pay
- Concern over company strategic direction
- Equity issuance
- Share issuance proposals

With challenges coming from so many corners, preparation is key in defending UK companies against activists:

- Understand your shareholders: What do your investors want, not just in terms of individual fund managers but also funds as a whole? What are they buying and selling and why? What are the patterns? Get in early. Consider a roadshow at the start of the year.
- Know your investors' strategies, requirements and sentiment towards your equity story. Set the scene for the future as this should be an ongoing, year-on-year discussion.
- Make sure your company has good remuneration practices, governance, structure, a strong business model and ESG practices that are clearly and transparently reported upon.
- There is a strong correlation between the voting recommendations of ISS and Glass Lewis and the actual votes logged by investors, so make sure you engage effectively with proxy advisers.
- Consider engaging with smaller investors, especially if you receive a negative vote from proxy advisers.

In the US, similar preparation is key:

- Know who your shareholders are, and which proxy advisory firm they follow, if any.
- Be in contact with your institutional investors, at least on a quarterly basis, and know who the voting decision maker is. Having an ongoing relationship will tune you into potentially problematic situations. In this way, the first time you are speaking to your investors is not when a problem arises, or you are asking for a particular vote.
- If an activist approaches your company…
  - o Understand what the situation is, the background and what the investor is trying to achieve. Listen to the activist.
  - o Speak as one voice. You do not want the dissident reaching out to individual directors and potentially creating a wedge between them.
  - o Put a good team in place, including appropriate lawyers, governance advisory personnel, proxy solicitor, investment bankers and a PR firm.

Conclusions

There has undoubtedly been a broadening of the definition of "corporate governance". Public companies now need to consider every aspect of their set up and how they do business – from their social and environmental impact to cyber security and data usage, employee representation and company ownership.

What is sometimes forgotten is that during preparation for Proxy Season is that both sides of this relationship want the same things: to make money sustainably and behave socially responsibly. Rather than boards or investors taking an adversarial approach, instead collaboration is key, creating long-term relationships where questions can be discussed before they become issues and judicious solutions can be reached without haste. To do this effectively:

- Be aware of the recommendation frameworks employed by proxy advisers and how their policies are aligned to the strategies used by key shareholders.
- Highlight good and improving corporate governance performance throughout the financial calendar.
- Ensure key non-executive members of the Board and committees know that shareholder engagement is a component part of the job, not an optional extra.
- Carefully consider resolution and policies including employee representation, paying particular attention to the experience and job descriptions of the nominees.
- Ensure NED nominations are supported by detailed biographies highlighting the relevant expertise required by the UK Corporate Governance Code and aligned to a transparent skills matrix.
- In the event of likely shareholder dissent at 20% or more for a resolution, engage quickly and actively with shareholders and prepare for the potential to be placed on The Public Register by aligning the reporting process with the financial calendar.

While we talk about "Proxy Season" as if it is a one-off period of the year, in reality, monitoring and engaging with shareholders is anything but short-term. No meaningful movement can be made in the few days leading up to an AGM. Identifying and addressing vulnerabilities is a year-round endeavour.

About Equiniti

The corporate governance landscape is evolving at speed. With ever-changing regulations and increasing shareholder expectations, businesses need considered corporate governance and IR strategies in place.

Equiniti offers a cover-all approach to building durable governance foundations and maintaining strong investor ties. We help businesses meet complex regulatory requirements while also taking into account the nuances of each organisation and their unique shareholders.

Using our in-depth knowledge of listed company boardrooms, we offer impartial advice to help boards, individual directors, company secretaries and IR teams become more effective in their governance and investor relations approach.

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