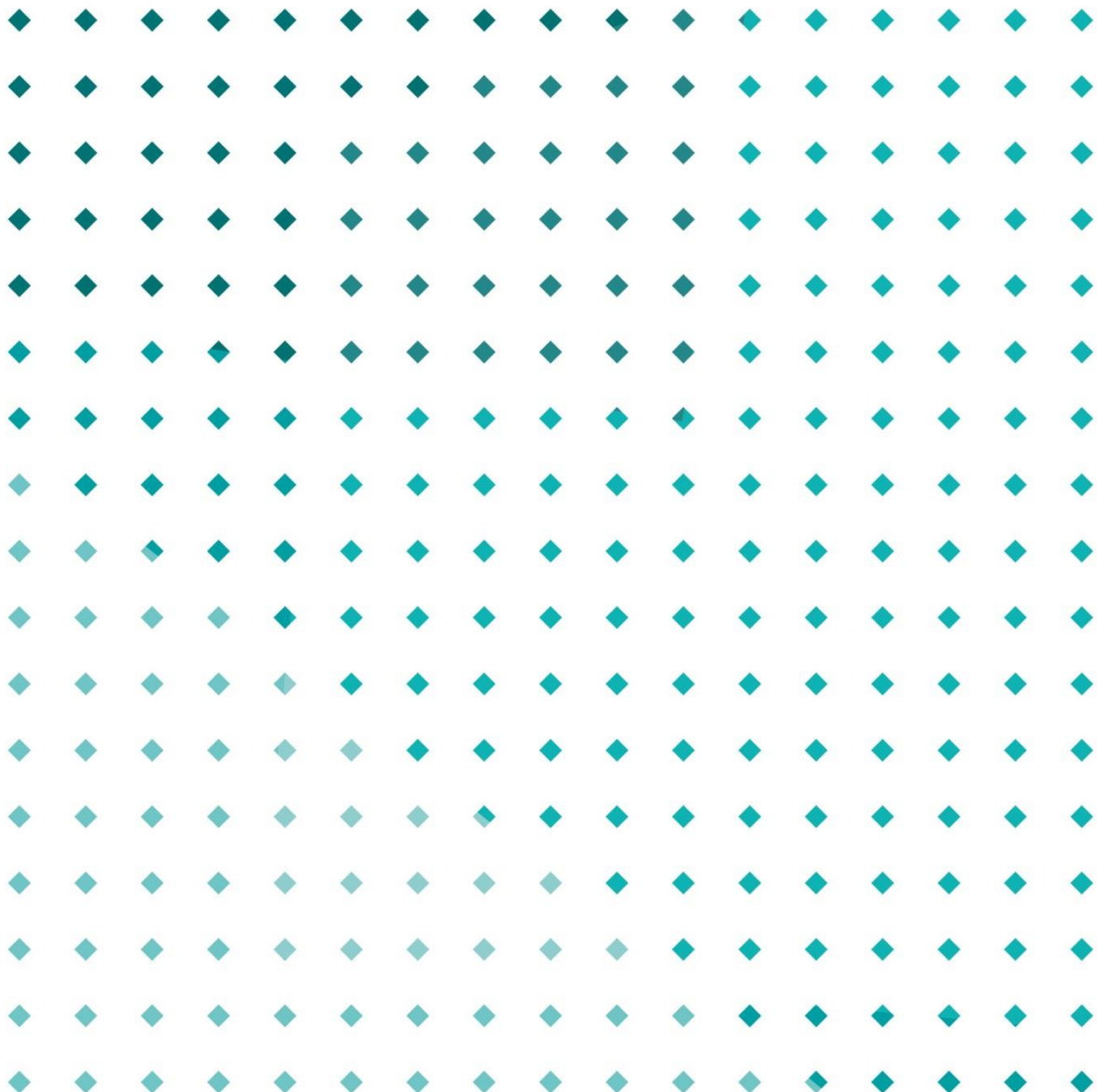


# **CORPORATE GOVERNANCE POLICY AND VOTING GUIDELINES 2017**



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## OVERVIEW

Members of the Pensions and Lifetime Savings Association have a clear interest in promoting the success of the companies in which they invest. As a consequence of this, the Association has long considered that one of its prime functions is to support members in engaging with investee companies. Our efforts are directed towards maximising the long-term returns of pension schemes' assets, irrespective of the potential for short-term discomfort.

The Corporate Governance Policy and Voting Guidelines seek to reflect current market best practice as determined through consultation with its members. The aim of this document is to assist members in:

- Promoting the long-term success of the companies in which they invest.
- Ensuring that the board and management of these companies are held accountable to shareholders.

## CORPORATE GOVERNANCE

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

As articulated within the 2014 UK Corporate Governance Code (the "Code"), corporate governance is in essence about "what the board of a company does and how it sets the values of the company". An effective board is therefore crucial and should be composed of a diverse grouping of directors each of whom is committed to contributing to the governance and long-term success of the company.

Truly effective corporate governance is reliant upon a company's willingness to engage with the spirit of the Code rather than simply about compliance with its Principles. In parallel it is equally important that investors play their part and take their responsibilities seriously, monitoring, engaging with and ultimately holding accountable those individuals whom they have elected to the board.

## A HOLISTIC AND SUSTAINABLE APPROACH TO CORPORATE GOVERNANCE

Assessments of corporate governance should be formed through the lens of directors' duties as set out in the Companies Act 2006. To restate, these include, in particular, the duty to promote the success of the company, while having regard to, amongst other things, 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 the communities and environment and 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.

### **SUSTAINABLE BUSINESS SUCCESS**

Boards should endeavour actively to consider how the company's strategy, governance arrangements, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and ultimately long term.

Building a sustainable business model should be central to the business strategy. We expect boards to explain to shareholders how they approach overseeing and managing the risks to their sustainability. In turn shareholders may well form judgments on the management of these issues which will inform their understanding of the effectiveness of the board oversight and so guide their approach to resolutions at the AGM.

### **THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION'S CORPORATE GOVERNANCE POLICY & VOTING GUIDELINES**

The Pensions and Lifetime Savings Association's Corporate Governance Policy & Voting Guidelines endeavour to build on the above context while remaining firmly rooted in the provisions of the Code and the underlying principles of all good corporate governance, namely, accountability, alignment, transparency and integrity.

The Guidelines aim to assist investors and their proxy voting agents in their interpretation of the provisions of the Code and in forming judgements on the resolutions presented to shareholders at a company's AGM. While it is particularly focussed on what voting sanctions may be applied at a company meeting, a decision to vote against management should only be taken after proper consideration of the company's explanation for non-compliance, in the light of the particular circumstances at that company and ideally after engagement.

### **ROLE OF SHAREHOLDERS**

The Association recognises that the success of the Code relies to a large part upon investors acknowledging and assuming their own stewardship responsibilities. To that end, we are firm supporters of the Stewardship Code and the mind-set that underlies it – in particular that companies with engaged shareholders will perform better over the long run.

We recognise the important role that investors play in making sure that companies genuinely feel there to be scope for explanations as well as compliance with the strictures of the Code. Where the views of boards and their shareholders differ on matters of corporate governance, it is to be hoped that constructive discussion will follow, albeit that ultimately shareholders will exercise their rights as owners to do what they see as necessary to protect their interests.

We encourage companies to make efforts to identify their long-term investors - those investing with long-term objectives rather than those involved in short-term trading - to enable regular and strategic dialogue with a critical mass of engaged investors. Equally, it is important that investors are open to engagement on the full range of substantive matters.

The Association for its part is always willing to facilitate active engagement between issuers and pension fund investors in order to discuss substantive matters of concern or company-specific issues. We will initiate a proactive set of engagement dialogues for our members with relevant companies on key strategic issues where we believe long-term value may be at stake.

## UK CORPORATE GOVERNANCE PRINCIPLES

- ▶ **The Pensions and Lifetime Savings Association supports the UK Corporate Governance Code.** The Code is the benchmark from which this Policy seeks to build in an effort to promote the sustainable success of companies.
- ▶ **Adherence to the spirit of the Code is important.** Good corporate governance is all about achieving long-term sustainable business success, not mere compliance.
- ▶ **Governance should be considered holistically.** Boards should endeavour to set the cultural tone from the top and give full consideration to understanding and in turn mitigating long-term risks to its financial sustainability.
- ▶ **Boiler-plate which provides little data or insight must be avoided.** Our members expect clear and specific explanations to be provided for non-compliance with Code provisions including relevant insights and a convincing rationale for choosing to over-ride the provisions of the Code. Equally, shareholders must be prepared to listen to and give consideration to these explanations. Good corporate governance and its reporting is a matter of principle and nuance, not dogma.
- ▶ **Prompt and effective communication** on corporate governance issues, including with respect to changes in board structures and responsibilities, and remuneration policies, greatly assists in developing good relations between companies and their shareholders and avoids unnecessary surprises
- ▶ **The Nomination Committee is vital and should anticipate change** by ensuring the proper planning of succession; ensuring boards are equipped with a diversity of perspectives, skills and experience. Boards should endeavour, where feasible, to consult their long-term investors over sensitive board appointments.
- ▶ **The Remuneration Committee should design 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 of their long-term owners in order to position themselves best for future success.
- ▶ **The Audit Committee has arguably the most complex brief** of any of the board committees. It should be staffed solely by independent directors and enjoy sufficient relevant experience to carry out its responsibilities to a high standard. We encourage Audit Committees to continue to take ownership of the audit relationship and be open to engagement with investors on matters within their remit.
- ▶ **The Pensions and Lifetime Savings Association supports the principle underlying pre-emption rights** except where a clear case is made for these not being applied in the context of the best interests of all of the owners of the company concerned. Similarly, in order to protect the rights of existing shareholders and reinforce the

accountability of management to the company's owners, the Association generally opposes the creation of "poison pill" provisions.

- ▶ **Effective engagement with shareholders is crucial.** Companies should take care to ensure their messages are clearly understood by their investors and in turn that their concerns are communicated to and considered by the board. The roles of the Chair and the senior independent director in these regards are of the greatest importance.
- ▶ **The Pensions and Lifetime Savings Association strongly supports the Stewardship Code** which sets out important principles for the role of institutional investors in monitoring and improving standards of corporate governance in the UK. As with the UK Corporate Governance Code, it is incumbent upon signatories to the Stewardship Code to demonstrate their commitment to the spirit of Code and communicate how they adhere to its principles in order to enhance and protect long-term value for their clients.
- ▶ **The Pensions and Lifetime Savings Association supports the OECD Corporate Governance Principles and ICGN Global Governance Principles.** These globally accepted standards of best practice provide a sound foundation for the development of market-specific codes of best practice for investors to adopt and support as part of their corporate governance programmes.
- ▶ **Smaller companies should seek to emulate best practice.** While the 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 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.
- ▶ **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 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.

## UK VOTING GUIDELINES

The general structure of these Guidelines is based around the core Principles of the Code followed by a discussion of the key issues. More detailed voting guidance is subsequently set out in the second section of the Guidelines mirroring the format of a standard AGM agenda.

**The voting recommendations assume that shareholders have evaluated explanations for non-compliance, taken account of a company's individual circumstances and engaged as appropriate. They should in no way be interpreted as being prescriptive.**

“Comply or explain” confers a dual responsibility: it is the company's duty to avoid “boilerplate” explanations, providing instead a thoughtful and justifiable explanation for areas of non-compliance. Conversely, shareholders need to evaluate these explanations with intelligence, taking care not to adopt a mechanistic approach and should make companies aware of the reasoning behind their votes on contentious issues. An effective “comply or explain” regime must be based on regular and open dialogue between companies and shareholders, which should extend beyond the voting season.

Voting decisions should always be made in the context of a company's overall governance arrangements and consider the progress, given that governance is always dynamic.

Certain corporate governance issues would not generally have voting consequences; an accumulation of minor issues, however, may be indicative of poor corporate governance. A holistic approach should be adopted when assessing corporate governance arrangements.

**Shareholders are encouraged to make systematic use of all of the powers at their disposal** as necessary in order coherently to support the highest standards of corporate governance at the companies in which they invest. Those which are more rarely used include: voting on the re-election of directors; the adoption of the annual report and accounts; the (re)appointment of the auditors; attendance and speaking at AGMs and tabling shareholder resolutions.

Finally, shareholders should always balance the “signalling” effect of a voting sanction against the potential for it to exacerbate the situation which they seek to remedy.



**SECTION A: LEADERSHIP****Principles from the UK Corporate Governance Code:**

- A.1. Every company should be headed by an effective board, which is collectively responsible for the long term success of the company.**
- A.2. There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.**
- A.3. The Chair is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.**
- A.4. As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.**

**GUIDANCE**

The board is tasked with promoting the long-term success of the company and is accountable to shareholders for protecting and generating sustainable value over the long term. The 2006 Companies Act also requires Directors to have regard for other stakeholders, including workers, customers, suppliers and wider society and the environment, and boards should be aware of these requirements when carrying out their work.

The challenge for a board and its Chair is to demonstrate to shareholders the effective application of good corporate governance. Shareholders will naturally look at financial results as one measure, but will also look for wider evidence that the Chair and the board as a whole are adhering to the spirit of the Code's Principles.

The roles of Chair and chief executive officer (CEO) are distinctly different and thus should be fulfilled by different individuals.

Shareholders also place particular importance on the appointment of a senior independent director (SID) as a key contact for shareholders when the normal channels of the Chair, CEO, or CFO have failed to address concerns or are not the appropriate avenues.

**SECTION B: EFFECTIVENESS****Principles from the UK Corporate Governance Code:**

- B.1. The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.**
- B.2. There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.**
- B.3. All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.**
- B.4. All directors should receive an induction on joining the board and should regularly update and refresh their skills and knowledge.**
- B.5. The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.**
- B.6. The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.**
- B.7. All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.**

**GUIDANCE**

The success of a board is down to its members' contribution and how the different roles and individuals work together collectively and effectively. Shareholders should seek to assess whether the quality and mix of individuals on the board gives them reassurance.

Shareholders have a reasonable expectation that boards should be effective in delivering results, over time, which are consistent with the company's stated strategy. In so doing, shareholders should assess the extent to which performance results can be attributed to poor or imprudent management judgements, weaknesses in corporate governance or external factors over which the board has limited control. The annual report should be used to set out the ways in which the board has sought to ensure its effectiveness.

Of particular concern to shareholders will be the following: independence of non-executive directors; succession and refreshment plans; board evaluation; and re-election rationale (including biographical details).

Given the importance of board effectiveness, the Pensions and Lifetime Savings Association strongly encourages companies to set out within the annual report the contributions in the year of individual directors and to provide a rationale for their election or re-election to the board. Such a statement should present shareholders with a full picture of the relevant skills,

contribution and experience that a Director is bringing to the Board. It should also include other current appointments which might affect his/her ability to make a full contribution to the work of the board.

The value of the tenure guideline of nine years is to drive refreshment of the board overall rather than marking a limit on the value offered by an individual. With increasing tenures directors will be subject to increasing scrutiny as to their effectiveness and independence. Most importantly boards should set out their forward looking succession and refreshment plans in detail when they propose the re-election of a long-serving non-executive director, especially when the director is chairing an important board committee.

Shareholders will look for evidence of implementation of a succession plan and its link to the company strategy. Advanced communication with shareholders when board changes are planned will help allay any concerns. A statement on succession should cover the board's policy on diversity, including gender. The disclosure should set out clearly the board's approach to succession planning, any changes anticipated in the next year(s) and its diversity objectives and progress towards achieving them, bearing in mind the need to develop the right skills, experience and diversity of perspectives and personalities on the board – reference should be made to the efforts to develop talent internally in order to create a pipeline to the board.

We view board evaluation as an important tool for all boards. Companies are encouraged to 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 the subsequent actions taken.

## SECTION C: ACCOUNTABILITY

### Principles from the UK Corporate Governance Code:

- C.1. The board should present a fair, balanced and understandable assessment of the company's position and prospects.**
- C.2. The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.**
- C.3. The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.**

### GUIDANCE

Shareholders expect the accounts to present a “true and fair” view of the state of affairs of the business, its assets, liabilities, financial position and profit or loss in a succinct and fair and understandable manner. The report should cover the key elements of the business, by size and by risk exposures. It should, in a clear and understandable fashion, explain how the company generates value from its key tangible and intangible assets. Reporting should also set out the board's view of the key strategic and operating risks, including environmental, social, governance and reputational risks, facing the business.

In the Summer 2016, the Pensions and Lifetime Savings Association produced a toolkit for our members, highlighting the importance of a company's workforce to its long-term success and recommending pension fund investors encourage investee companies to disclose more details of their corporate culture and working practices. Corporate reporting should detail the composition; stability; training and skills; and engagement levels of a company's workforce, explaining how this relates to the underlying business strategy as well as the risks and opportunities that derive from the employment models and practices.

Furthermore, it is crucial that the understanding and reporting of risk remains a dynamic and continually evolving and refining process. Examples of emerging risks may include those from cyber security and climate change; such risks should be appropriately considered as should risks which relate to issues such as a company's approach to tax management which, in addition to posing a financial risk, may also pose a risk to its reputation and brand value.

Most importantly companies should communicate how these risks are managed and what changes have occurred in relation to these risks over the course of the past year. Where a risk materialised over the past year the report should communicate how the company is responding.

The Pensions and Lifetime Savings Association supports the application of the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting and Guidance on Audit Committees. Shortcomings by companies and their boards in these areas are likely to be causes of concern to shareholders.

We strongly support the on-going evolution and improvements to audit committee and auditor reporting. It is important that efforts to avoid 'boilerplate' language are maintained and the audit committee report should seek to provide sufficient 'colour' to enable shareholders to form a judgement about the committee's work in the year, in particular how the committee assessed the quality of the audit.

Lengthy audit tenures have the potential to impact on the actual, or perceived, independence of the external auditor. As such the Code's current provision whereby FTSE 350 companies should put the external audit contract out to tender at least every ten years should be seen as minimum expectation<sup>1</sup>.

A rigorous tendering process should enable the audit committee to compare the quality and effectiveness of the services provided by the incumbent auditor 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. The tender process should focus on audit quality and not cost.

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<sup>1</sup> We note that the Code provision is soon to be superseded by the implementation of the EU Audit Directive and Regulation

## SECTION D: REMUNERATION

### Principles from the UK Corporate Governance Code:

- D.1. Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.**
- D.2. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.**

### GUIDANCE

Remuneration is seen by many investors as a litmus test for wider corporate governance practices; it encompasses board effectiveness, challenge and oversight, strategy and risk management. Shareholders will therefore continue to examine remuneration policies critically, with a view to ensuring that they are closely aligned with their interests and are driving long-term strategic success.

The Pensions and Lifetime Savings Association's "Remuneration principles for building and reinforcing long-term business success" were published in 2013 in conjunction with Hermes EOS, BT Pension Scheme, RPMI Railpen and USS Investment Management. These set out a framework for remuneration committees to use when thinking through, devising and implementing their remuneration policies. Investors do not wish to micro-manage businesses and thus will hold the remuneration committee accountable for making appropriate judgements. We expect remuneration committees to take ownership of the design and implementation of the remuneration policies and for companies to articulate how their pay policies meet the Principles in a manner which is most appropriate for them.

- 1. Remuneration committees should expect executive management make a material long-term investment in shares of the businesses they manage**
- 2. Pay should be aligned to long-term strategy and the desired corporate culture throughout the organisation**
- 3. Pay schemes should be clear, understandable for both investors and executives, and ensure that executive rewards reflect returns to long-term shareholders**
- 4. Remuneration committees should use the discretion afforded them by shareholders to ensure that awards properly reflect business performance**
- 5. Companies and shareholders should have appropriately regular discussions on strategy and long-term performance.**

There is also growing concern at the size of executive pay packages as well as their structure. Executive pay policy should be clearly aligned with pay policies in the company as a whole and mindful of the wider societal expectations. We encourage a coherent remuneration philosophy which is consistent through the organisation. Ever widening pay differentials are

often difficult credibly to justify and boards should be mindful of the possible negative impact on corporate culture and staff morale of widening inequality within the organisation. The evidence that pay incentives are necessary to motivate or reward executives and to achieve success for companies is questionable. Remuneration Committee deliberations should take a critical and challenging approach to pay increases and be prepared to exert downward pressure on executive pay.

We would like to see remuneration policies being designed and put to shareholders with the expectation that they will stand the test of time. As such remuneration policies should on the whole be put to a vote on a triennial rather than an annual basis. In parallel, annual reporting should be transparent and clearly explain how pay is aligned to performance.

## SECTION E: RELATIONS WITH SHAREHOLDERS

### Principles from the UK Corporate Governance Code:

- E.1. There should be a dialogue with shareholders based on a mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.**
- E.2. The board should use the general meetings to communicate with shareholders and to encourage their participation.**

### GUIDANCE

The directors of a company should be accessible to shareholders and should make themselves available to engage on any issues whether or not related to a vote at the company's general meeting. Concerns raised by shareholders should be managed effectively by the board.

The Pensions and Lifetime Savings Association has consistently advocated constructive dialogue between companies and their shareholders and facilitates such dialogue on an ad hoc basis or at the behest of members when concerns arise. Investor engagement is a cornerstone of effective and responsible ownership. For this dialogue to be most effective it should take place throughout the year, rather than being compressed into the period leading up to the shareholder meeting. Both companies and investors should be prepared and equipped to have intelligent, holistic conversations about the business and its strategy and how governance arrangements support this.

Shareholders should be clear about their investment objectives when discussing governance and strategy with a company, so the Chair and directors are able better to understand what is expected of them. They should also make it clear to a company where decisions on both investment and voting rest.

The AGM is an important part of the dialogue between a company and its shareholders, regardless of size, as well as being 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. Attendance and speaking at the AGM can also be an effective way of expressing views about the company, not least when concerted attempts at engagement have failed to achieve a satisfactory resolution.

Companies should publish the results of the general meeting as soon as practicable after the meeting and should include in this disclosure a record of votes withheld. Where a significant number of votes on a particular resolution – based upon the judgement of the board and in the context of the type of resolution - have not been registered in support of management (meaning both votes against and active abstentions) the board should acknowledge this within its RIS statement and communicate as soon as reasonably possible following the AGM how it intends to engage with shareholders in order to understand the reasons for dissent.



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

This section links closely to the Stewardship Code. The Pensions and Lifetime Savings Association's Stewardship Central website provides further guidance and tools for pension funds and other investors to utilise in understanding and fulfilling their stewardship responsibilities. In addition our Stewardship Accountability Forums provide pension funds with the opportunity to collectively question the senior figures within leading asset management firms about their approaches to stewardship.

## **APPENDIX 1: DETAILED VOTING GUIDELINES**

### **INTRODUCTION**

In this section we have not repeated the detailed provisions of the UK Corporate Governance Code, but have sought in the order that resolutions typically appear on an AGM agenda, to identify those issues which will be of particular importance to shareholders when assessing a company's compliance with the Code and deciding what voting sanctions, if any, to apply.

A significant number of the Code's provisions relate to disclosure of information about the board or its governance practices, without which it can be very difficult to arrive at an informed opinion about the quality of its compliance. Poor levels of disclosure are likely to lead shareholders to take a less sympathetic view of explanations of non-compliance.

## RESOLUTION 1. ANNUAL REPORT & ACCOUNTS

- 1.1. A company's board should present a fair, balanced and understandable assessment of the company's position and prospects. This reporting should cover both the financial and non-financial, and outline how the board has fulfilled its responsibilities. Boilerplate disclosure should be avoided.
  - ▶ **In the event of limited or boilerplate disclosure about the corporate governance arrangements shareholders may wish to vote against the adoption of the report and accounts;**
  - ▶ **In extreme circumstances shareholders may wish to vote against the re-election of the Chair, or submit a shareholder resolution.**

### STRATEGY AND BUSINESS MODEL

- 1.2. Shareholders expect a clear elucidation of the business model, strategy and culture and for the clarity on these areas to flow through all areas of the annual report. The strategic report should provide a clear articulation of how the company's key assets – including human, physical and intangible assets - are engaged in the generation of sustainable value creation and clear connections made to the chosen financial and non-financial KPIs and the reciprocal link with executive pay.
- 1.3. In Summer 2016, the PLSA published a 'toolkit' for pension funds, identifying improvements to reporting of corporate culture and how the company's employment model and working practices relate to its underlying purpose and business model. A company's workforce is critical to its long-term success, and strategic information in this respect should be a key component of the annual report.
  - ▶ **Disclosure of the business model and strategy which fails to convey how the company intends to generate and preserve value over the longer term may lead to a vote against the report and accounts, or the submission of a shareholder resolution.**
  - ▶ **Gathering the data necessary to clearly communicate the composition, stability, skills and engagement levels of a company's workforce may be a medium to long-term process, but if shareholders do not see better disclosure in this area in coming years, a vote against the annual report would be appropriate.**

### RISK MANAGEMENT AND VIABILITY

- 1.4. Shareholders expect to see appropriate prominence given to risk management, and in particular a focus on risk in the context of the business strategy, its size and global footprint, its assets, liabilities and the wider political and regulatory environment.
- 1.5. Shareholders expect that company directors articulate whether they have a reasonable expectation that the company will remain a viable and sustainable

enterprise. In assessing viability they are expected to consider all risks which might impact the ongoing viability of the company including those matters such as a licence to operate and those which may manifest in the short, medium and longer term. Disclosures should build on the disclosures contained within strategic reports and be concise, thoughtful and company specific. Greater reassurance is likely to be gained from assessments which are evidently open and transparent rather than ones which appear boiler-plated and heavily caveated.

- 1.6. There are no hard and fast rules over what the right time period is for these viability statements, it is however, important that companies are clear about why they think the period chosen makes sense for their circumstances.
- ▶ **Poor disclosure of the strategy and risk exposures may lead to a vote against the report and accounts.**
  - ▶ **The lack of a disclosed review of the company's risk management and internal control systems would likely result in a vote against the report and accounts.**
  - ▶ **The lack of a viability statement, looking out over multiple years, or one which does not evidently consider a full range of risk factors would likely result in a vote against the report and accounts.**
  - ▶ **In the event of extreme concerns or persistently poor disclosure shareholders may consider voting against the Chair and/or submitting a shareholder resolution.**
- 1.7. Companies should consider the broader strategic risks, including environmental, social and reputational risks, facing the business and give comment on those in the annual report.
- 1.8. In addition, shareholders expect that where a risk has materialised within the year that the company sets out how it has responded and what efforts have been taken to mitigate the risk going forward.
- ▶ **A lack of, or poor quality, reporting on environmental, social and reputational risks may warrant, after engagement, a vote against the annual report and accounts, or the submission of a shareholder resolution.**

## BOARD EVALUATION

- 1.9. An effective board evaluation process, utilising at least every three years an independent external facilitator, is seen by shareholders as an important part of a company's governance processes. Companies are expected to provide details of the approach adopted and broad conclusions reached from the evaluation in their annual report.

1.10. At a minimum, the board should seek to provide the following details:

- ▶ When the review took place and when a subsequent review is planned;
- ▶ What was specifically reviewed (including rationale behind this decision);
  - ▶ Who conducted the evaluation, and whether they were internal or external appointments (including rationale behind their selection);
  - ▶ The nature of the process;
  - ▶ The key findings and lessons learned; and
  - ▶ Any follow up required, and by whom.
- ▶ **Where engagement has failed to result in better disclosure, shareholders may wish to vote against the adoption of the report and accounts;**
- ▶ **Subsequently if practice does not improve (or there is consistently no independent board evaluation conducted) dissent may be escalated to a vote against the Chair of the company.**

#### BOARD DIVERSITY

1.11. Shareholders expect companies to explain what steps they are taking to bring diversity in all its guises to their boardroom, including gender diversity. The report & accounts should include a description of the board's policy on diversity – including professional, international and gender diversity - any measurable objectives that it has set for implementing the policy, and its progress against these objectives.

1.12. The progress in recent years towards meeting the Davies target of 33% of women on FTSE 100 Boards has been positive but there is still considerable room for improvement in some cases and shareholders expect this momentum to be maintained.

- ▶ **Shareholders could consider voting against the Report & Accounts if a diversity statement is not disclosed, or is not considered satisfactory..**
- ▶ **If there is no clear evidence that diversity is being sufficiently considered by the board then a vote against the Chair (or Chair of the Nominations Committee, if not the same individual) may be warranted.**
- ▶ **The Davies Report and 33 per cent target is a useful benchmark for gender diversity, and a failure to move closer to the target is one example of a criterion that could justify a vote against the re-election of the Chair or Chair of the Nominations Committee.**

- ▶ **Similarly, the 2016 Parker report proposed an ethnic diversity target of no 'all white' boards by 2021 and progress towards this target is another useful measure of whether diversity is being sufficiently considered.**

#### **CHAIR AND DIRECTORS' JOB SPECIFICATIONS/TIME COMMITMENT REQUIRED**

- 1.13. It is important that shareholders have access online to the terms and conditions on which directors are appointed and 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.
  - 1.14. The issue of time commitment is especially pertinent to the role of chair, particularly where a company is both complex and global in scale and furthermore if it operates within a highly regulated sector such as financial services.
- ▶ **In the event of poor disclosure, shareholders may wish to vote against the adoption of the report and accounts.**

## RESOLUTION 2. APPROVAL OF THE REMUNERATION POLICY

- 2.1. The Pensions and Lifetime Savings Association believes that remuneration should be proportionate and aligned with shareholder interests and long-term sustainable value creation.
  - 2.2. The Remuneration principles for building and reinforcing long-term business success are intended to provide high-level guidance to companies about investor expectations of their remuneration structures and practices. The Principles deliberately avoid prescribing specific structures or measures; however, we do expect companies to articulate how their pay policies meet these Principles in a manner which is most appropriate for their company – the Committee Chair’s statement provides useful scope to do this.
1. **Remuneration committees should expect executive management make a material long-term investment in shares of the businesses they manage**
    - i. To the extent this is feasible and appropriate the bulk of variable rewards should flow over time from the benefits of being an equity owner.
    - ii. Companies should also consider ensuring that executives are exposed to some tail risk for an appropriate length of time once they leave a company.
  2. **Pay should be aligned to long-term strategy and the desired corporate culture throughout the organisation**
    - i. Remuneration committees should take as a starting point the company’s strategic plan and key performance indicators and ensure there is a strong read across from the company’s strategy to the drivers of executives’ remuneration.
  3. **Pay schemes should be clear, understandable for both investors and executives, and ensure that executive rewards reflect returns to long-term shareholders**
    - i. Incentive schemes should be simple to understand. Firms should avoid operating multiple long-term schemes – we do not believe that a multiplicity of awards, with varying performance conditions helps to motivate executives.
  4. **Remuneration committees should use the discretion afforded them by shareholders to ensure that awards properly reflect business performance**
    - i. Remuneration committees should exercise their judgement about the overall performance of the company when determining awards. In particular, the committee should consider how the results have been achieved, not just what was achieved.

**5. Companies and investors should have appropriately regular discussions on strategy and long-term performance.**

- i. Dialogue should be initiated at an early stage of the decision making process and include those investors who are committed to stewardship.

**2.3** Pay policies should ensure that maximum pay-outs remain in line with the expectations of shareholders and other stakeholders, including workers and wider society. The pay policy should not enable any pay award larger than that necessary to successfully execute the company's wider strategy, and to incentivise and reward success.

- ▶ **If shareholders judge that the company's remuneration policy fails to meet the Pensions and Lifetime Savings Association's Principles then they may decide to vote against the policy.**
- ▶ **Pay policies likely to result in pay awards that could bring the company into public disrepute or foster internal resentment, owing to their excessive value and/or the overly-generous incentives and rewards that they offer, also justify a vote against the policy.**
- ▶ **If 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 part of the Chair of the remuneration committee in the most fundamental aspect of their role. As such, a vote against the remuneration policy should in most circumstances be accompanied by a vote against the Chair of the remuneration committee, if they have been in post for more than one year.**
- ▶ **In the event of a vote against a revised remuneration policy, if the revised policy continues to fail to meet the principles outlined in these guidelines, it may also be appropriate to vote against the Chair of the Board.**

**2.4** Shareholders will seek reassurance that there is a clear link between strategy, performance and reward. Total remuneration should be structured to reflect the ambitions and risks inherent in the business and be mindful of both the wider economic climate and the impact on the general workforce. Performance pay should motivate management to deliver business results which are both stretching and sustainable but should not result in awards in excess of what is necessary to motivate or reward good performance.

- ▶ **A vote against the remuneration policy may be warranted in the below circumstances:**



- ▶ Insufficient alignment with shareholders. An indication of insufficient alignment may include, but not be limited to, a shareholding requirement of less than 2x salary. Higher levels may be warranted commensurate with higher levels of reward.
  - ▶ Inappropriate metrics or insufficiently stretching targets for annual bonus or LTIP and/or a lack of read across between metrics used and the company's strategy.
  - ▶ Pension payments or payments in lieu of pension worth over 50 per cent of annual salary
  - ▶ Failure to disclose or retrospective disclosure of variable pay performance conditions for annual bonuses.
  - ▶ An absence of provisions to enable the company to claw back sums paid or scale back unvested awards –these provisions should not be restricted solely to material misstatements of the financial statements.
  - ▶ An excessive amount of flexibility being provided for 'exceptional' circumstances.
  - ▶ A recruitment policy that is vague or provides unlimited or substantial headroom over and above existing plans.
  - ▶ Guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments.
  - ▶ Any provision for re-testing of performance conditions.
  - ▶ Layering of new share award schemes on top of existing schemes.
  - ▶ Excessively generous salary or performance-related pay awards.
- 2.5** The resolutions on the remuneration policy and annual remuneration report are viewed independently by shareholders. While one does impact the other, a vote for or against one does not necessarily require a vote for or against the other. It is important for both shareholders and companies to communicate in order to understand the rationale behind voting decisions.

### RESOLUTION 3. APPROVAL OF THE REMUNERATION REPORT

- 3.1** Remuneration committees should exercise their judgement about the overall performance of the company when determining awards. In particular, the committee should consider how the results have been achieved, not just what was achieved.
- ▶ **Where awards made fail to reflect wider circumstances such as serious corporate conduct issues which have arisen, or alternatively if discretion has been used in an upwards direction without appropriate explanation then shareholders may wish to vote against the remuneration report.**
  - ▶ **Remuneration practices which are likely to cause concern and may trigger a voting sanction against the remuneration report in the absence of a convincing explanation include:**
    - ▶ Annual pay increases in excess of inflation or those awarded to the rest of the workforce.
    - ▶ Over frequent re-benchmarking.
    - ▶ An awarding of a ‘sign-on’ bonus without the inclusion of any conditionality and which pays for awards not already vested at previous employer.
    - ▶ Ex-gratia and other non-contractual payments.
    - ▶ Change in control provisions triggering earlier and/or larger payments and rewards.
    - ▶ The absence of service contracts for executive directors.
    - ▶ Inappropriate or inadequate use of discretion, for example not scaling back awards in light of *how* performance was achieved, or in light of wider factors relating to the company, and its conduct, reputation and relationship with key stakeholders.
- 3.2** The resolutions on the remuneration policy and annual remuneration report are viewed independently by shareholders. While one does impact the other, a vote for or against one does not necessarily require a vote for or against the other. It is important for both investors and companies to communicate in order to understand the rationale behind voting decisions.
- 3.3** As with the remuneration policy, a successful remuneration report requires the Chair of the remuneration committee to work effectively with shareholders to understand their concerns, and to exercise their judgement and discretion appropriately. Failure to do so represents a significant failure to carry out their most important duties as committee chair.

- ▶ **In most circumstances, shareholders should vote against the re-election of the remuneration committee Chair, if they have been in post for more than one year, and other committee members as appropriate, if they vote against the remuneration report.**

**3.4** The PLSA's 2016 AGM report highlights how high levels of shareholder dissent on remuneration related votes are too rarely heeded by companies:

- ▶ **Given that the vote on the remuneration report is advisory and that many companies are too slow to heed the message on remuneration, it is more appropriate for shareholders to vote against any remuneration report that they feel unable to support, rather than abstain**

## RESOLUTION 4. RE-ELECTION OF THE CHAIR

### DIVISION OF RESPONSIBILITIES - JOINT CHAIR / CHIEF EXECUTIVE

- 4.1 Separation of the roles of Chair and chief executive is 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 would cause significant concern.
- 4.2 The 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 his/her successor. But companies will not wish to give their shareholders the impression that such short-term fixes are being ill-managed and allowed to persist excessively.
- ▶ **Shareholders should consider voting against the board Chair in the event of the role being combined without a convincing explanation or where an ‘interim’ period extends for more than one year or where there is evidence of poor succession planning.**

### AVAILABILITY

- 4.3 Satisfactory engagement between company boards and investors is crucial to the health of the UK’s corporate governance regime. It is crucial that the Chair is engaged with the company’s shareholders on governance and strategy matters and conveys the relevant sentiments back to the board as a whole.
- ▶ **Any decision by the Chair to decline a legitimate shareholder request for a meeting, or to fail to find a mutually convenient time without undue delay, may lead that shareholder to decide not to support the re-election of the Chair at future AGMs.**
- 4.4 Engagement and dialogue offers investors the opportunity to assess the quality of and gain insight into the effectiveness of a board member, in particular the Chair.
- 4.5 Alongside judgements formed through engagement, shareholders will consider the history of the Chair when contemplating support for his/her re-election. Particular care is required where the Chair has had significant involvement, whether as an executive director or non-executive director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.
- ▶ **Given that governance is more about individuals than box-ticking, a shareholder may take a negative voting decision based on the assessment they have formed of a Chair through engagement.**

### INDEPENDENCE

- 4.6 If a new Chair has been appointed or a successor to the current Chair has been announced/proposed, the board should provide shareholders with confirmation in the

annual report that the past/retiring Chair was not involved in the selection or appointment of his/her successor.

- 4.7** If the Chair is not independent on appointment, the company should consult its investors and provide a detailed explanation as to why it considers the appointment desirable. Investors will wish to approach each case on its individual merits. The calibre of the individual, the balance of the board, and the nature of the impediment to the proposed chair's independence may all be factors in investors' deliberations.
- 4.8** The succession of the CEO to Chair is a significant issue, acceptable only on rare occasions. The company should enter into early dialogue with its investors and provide a meaningful explanation for the proposed succession. Investors would expect confirmation that external search consultants had been engaged and that external candidates of at least equivalent stature had been actively and fully considered.
- 4.9** The complexity of the business is an insufficiently persuasive argument in itself to justify succession of CEO to Chair. Given the issues posed by a former CEO assuming the Chair of the board, it is important for shareholder approval to be sought at the AGM coinciding with or following his/her appointment.
- 4.10** The Pensions and Lifetime Savings Association appreciates that voting against the election of a Chair is a decision with broader implications. However, this must be balanced against the requirement for a Chair to have sufficient time to fulfil his/her responsibilities and to be independent on appointment. These are issues which call for extensive dialogue between companies and their owners.
- ▶ **In the above cases, shareholders may consider voting against the new Chair alongside a vote against the individual responsible for the appointment process – likely the SID.**

## BOARD DIVERSITY

- 4.11** Ensuring the right balance of skills and experience on the board is crucial to ensure that the board is in position to operate effectively.
- 4.12** Shareholders will expect companies to explain what steps they are taking to bring diversity in all its guises to their boardroom, including gender diversity. This section should include a description of the board's policy on diversity – including professional, international and gender diversity - the measurable objectives it has set for implementing the policy, and its progress against these objectives.
- ▶ **The absence of a policy on diversity or the successful implementation of measurable targets, or insufficient progress has been made towards achieving a satisfactory level of diversity on the board may result in opposition to the re-election of the Chair or where different the chair of the nomination committee.**

**BOARD SUCCESSION**

**4.13** Board refreshment and succession planning is one of the most important issues for consideration by shareholders. In particular it is crucial to ensure that appropriate and sufficiently flexible succession plans are in place for the CEO and Chair. Board refreshment should be a continuous and evolving process.

**4.14** Shareholders recognise the confidential or sensitive nature of some succession planning issues which may make disclosure more difficult. However, companies should disclose as much information as is feasible about the company's succession plans which:

- ▶ Looks out over multiple years.
- ▶ Covers any identified skills shortages.
- ▶ Pays particular attention to the Chair and CEO.
- ▶ **The absence of a disclosed and reassuring succession plan may lead to shareholders, after engagement, to oppose the re-election of the Chair or where different the Chair of the nomination committee.**

**BOARD EVALUATION**

**4.15** The Pensions and Lifetime Savings Association views board evaluation as an important tool for all boards. Companies are encouraged to disclose details of the process and as far as possible the conclusions reached within the evaluation and the subsequent actions taken.

- ▶ **The absence of an evaluation process may lead shareholders to oppose the re-election of the Chair of the company.**

**TIME COMMITMENT**

**4.16** The issue of time commitment is especially pertinent to the role of Chair, particularly where a company is both complex and global in scale and furthermore if it operates within a highly regulated sector such as financial services. A chair's time commitment may be questioned where they are a director of more than four companies and/or a chair of two or more global and highly complex companies.

- ▶ **Shareholders may wish to consider voting against the re-election of an over-committed Chair, or submitting a shareholder resolution.**

## RESOLUTION 5. RE-ELECTION OF DIRECTORS

### AVAILABILITY

- 5.1 Satisfactory engagement between company boards and investors is crucial to the health of the UK's corporate governance regime. It is crucial that the board as a whole is engaged with the company's shareholders on governance and strategy matters.
- ▶ **Any decision by a director to decline a legitimate shareholder request for a meeting, or to fail to find a mutually convenient time without undue delay, may lead that shareholder to decide not to support the re-election of the Chair at future AGMs.**
- 5.2 Engagement and dialogue offers shareholders the opportunity to assess the quality of and gain insight into the effectiveness of a board member. Alongside this, the annual election of directors is important in providing accountability to shareholders.
- 5.3 In presenting directors for (re-)election, sufficient biographical details should comprise:
- ▶ A statement of a director's other directorships or trusteeships and responsibilities (including any relevant previous positions held) including those outside the corporate sector.
  - ▶ The experience and skills that they are bringing and the contribution that the director will make to the board and/or has made to the board during the year
- 5.4 In all cases, the board should explain to shareholders why it believes that the director should be re-elected and confirm that the director has recently been subject to formal performance evaluation in relation to the fulfilment of their duty to act in the long-term interest of the company on behalf of its members, while also having due regard for other stakeholders, as outlined in the 2016 Companies Act and continues to be an effective member of the board.
- 5.5 When the director is an independent non-executive proposed for re-election beyond nine years, a particularly rigorous review and evaluation process is to be expected.
- 5.6 Boards and shareholders should consider the history of a director when contemplating support for his/her re-election. Particular care is required where a director has had significant involvement, whether as an executive director or non-executive director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity. Shareholders rely heavily on the board's recommendation and directors should ensure that re-election proposals take into account not just the individual's performance on the board in question but also any external factors which may be relevant to that judgement.
- ▶ **Shareholders may choose to vote against the re-election of a director:**

- ▶ Where engagement with a director has informed a judgement on his/her effectiveness.
- ▶ In the absence of a supporting statement from the board.
- ▶ Where there is clear evidence of poor performance by the individual or the company.
- ▶ Where there is a record of poor attendance at meetings without a satisfactory explanation given.
- ▶ Where there is a failure of a specific aspect of reporting – for example an unsatisfactory audit committee report – in such circumstances investors may vote against the Chair of the relevant committee.

5.7 Where a company does not undertake annual re-elections, investors should expect a thorough explanation as to the rationale behind this decision.

- ▶ **Over time, a failure to move to annual director elections, especially where unsupported by an acceptable explanation, may lead to a vote against the re-election of the Chair and/or Chair of the nomination committee.**

#### DIRECTOR INDEPENDENCE

5.8 The issue of director independence calls for a particularly thoughtful application of the “comply or explain” principle. The onus is on the company to provide a detailed and considered explanation as to why it considers a director to remain independent despite the existence of one (or more) of the seven factors which the Code suggests may impair independence.

5.9 Length of tenure warrants a pragmatic approach from companies and investors. The principal value of the tenure guideline is to drive refreshment of the board overall rather than marking a limit on the value offered by an individual.

5.10 As the length of tenure increases directors will be subject to increasing scrutiny as to their effectiveness and independence, the company has a responsibility for explaining why a long-serving non-executive director remains independent and why board refreshment is not advantageous.

5.11 In considering the rationale for re-election of a long-serving director, investors will pay particular attention to the Board’s general refreshment and succession planning. It is in the interest of companies that they present as much detail as is feasible about their forward looking and ongoing board succession and refreshment plans.



**5.12** Furthermore, just as the company has a responsibility to consider independence carefully in these circumstances, equally shareholders will also wish to assess the company's explanation and may take account of some or all of the following factors:

- ▶ Overall corporate governance standards and history and wider independence on the board.
- ▶ Evidence of independence in the director's conduct.
- ▶ Confirmation that independence (as distinct from performance) was evaluated.
- ▶ The length of service of the executives. In general, concurrent tenure of an NED with an executive director for over nine years should lead shareholders to question the NED's independence.

**5.13** Where a director has served for over nine years concurrently with an executive director, that director should no longer be deemed to be independent. He/she should therefore no longer serve on those committees which should consist solely of independent directors.

**5.14** Where the presence of one (or more) non-independent non-executive directors impairs board balance, the role of such non-executive directors should be clarified. The company should justify why it believes the independent element is sufficiently strong to counter the imbalance and why the continued presence of the non-independent non-executive director is in the interests of the company and its shareholders.

**5.15** Where there is insufficient independent representation, investors will require a detailed explanation as to why the company's exceptional circumstances justify the situation. Ideally a timetable for compliance should be provided.

**5.16** Controlling shareholders (as defined by LR 6.1.2A) overriding the interests of minority shareholders has been the subject of increasing investor concern. Details of the relationship with a controlling shareholder should be disclosed to investors.

**5.17** Where a controlling shareholder is present, a relationship agreement is expected to be in place and this should detail any entitlements to governance arrangements such as board appointments. Exempting any details which are commercially sensitive, this agreement should be available to shareholders.

- ▶ **Voting sanctions against a non-independent non-executive director would normally be warranted only where the composition of the key committees or the balance of the board was compromised, other than because of the other reasons highlighted above.**

## ATTENDANCE

**5.18** Where a director has been unable to attend a number of board or committee meetings, both scheduled and ad hoc, a reasoned explanation should be provided in the annual

report. Unexplained low attendance rates will be a factor when shareholders consider the re-election of directors.

- ▶ **Where a trend of low attendance at meetings has been identified, in the absence of a sufficient explanation and perhaps over the space of more than one year, voting against the re-election of the director concerned may be an appropriate sanction.**

#### TIME COMMITMENT

**5.19** The non-executive director role is an increasingly demanding one – in particular when chairing a key committee – however, their role is invaluable to the effective governance of the company. It is crucial that directors have sufficient time and energy to fulfil their role properly.

**5.20** Shareholders will be mindful of concurrent directorships and will take account of the size of the company, its complexity, its circumstances and other commitments that a director has in forming a view as to the whether an individual director is over-committed.

- ▶ **For complex companies it may be appropriate to vote against the (re)election of a non-executive director who holds more than four directorships.**
- ▶
- ▶ **Where a director chairs a number of key committees a stricter view may be adopted, especially where an individual is a director of two or more companies in heavily regulated industries.**

## RESOLUTION 6. APPOINTMENT OF THE AUDITOR AND AUTHORISE REMUNERATION OF THE AUDITOR

- 6.1 Separate resolutions should cover the appointment of external auditors and the setting of (or the authorising of the board to set) auditors' fees. This is principally because shareholders may have concerns about the balance between audit and non-audit fees which need to be considered separately, or substantially so, to the appointment of the auditor alone.
- 6.2 Auditor independence is crucial to audit quality; as such investors will expect companies clearly to disclose their policy on audit tendering, including when the audit was last subject to tender and how they ensure independence is safeguarded.
- 6.3 Disclosure should cover the auditor re-selection decision along with any contractual obligations to appoint audit firms, in the interests of making the criteria used for auditor selection and evaluation as explicit as possible. Companies should also disclose the change of the audit partner and the process carried out by the audit committee to agree this appointment.
- 6.4 It should be communicated clearly that the decision in relation to nomination for appointment of the external auditor and scope of audit work is the responsibility of the audit committee.
- 6.5 Any change of auditors should be explained to shareholders and any plans to tender indicated in advance.
- ▶ **Where the tenure of the external auditor extends beyond ten years and there has not been a recent tender process and no plans to put the audit service out to tender are disclosed, shareholders should consider voting against the re-election of the audit committee Chair.**
  - ▶ **This voting sanction may be extended to a vote against the re-nomination of the auditor if subsequently no action is taken.**
- 6.6 Where the auditors have resigned, the resignation letter should be posted on the company's website.
- 6.7 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 close review, seeking to balance the maintenance of objectivity and independence with value for money.
- 6.8 There should be full disclosure of the value of all non-audit fees including a clear break-down between the types of services received, with tax compliance services

differentiated from tax advisory services and non-statutory acquisition-related services separated from statutory services.

- 6.9** The aggregate of non-audit fees should largely be constituted from audit related work. While the use of the company's auditors for non-audit work can on occasion be justified on grounds of cost and relevant expertise, more use should be made of third parties. On the whole company's should aim to spend no more than 50% of the audit fee on non-audit services and should not exceed a non-audit fee cap of 75% of audit (or a material monetary sum - £500k), absent an explanation of any exceptional circumstances which may apply. A company's clearly defined policy on non-audit work should form part of the audit committee's report to shareholders.
- ▶ **It would be appropriate to vote against the chair of the audit committee, and/or the audit fees, in circumstances where the non-audit fees exceeds 100% of the audit fee (or a material monetary sum - £500k) in consecutive years without an adequate explanation being provided.**
  - ▶ **Where there are major concerns regarding the audit process which are not satisfactorily resolved by the board, voting against the re-election of the Chair of the audit committee or, in exceptional circumstances, the reappointment of the auditor may be appropriate.**
  - ▶ **Where the auditor's report fails to address a key issue of importance, or is otherwise unsatisfactory, shareholder may choose to vote against the reappointment of the auditor and/or the audit fees.**

**RESOLUTION 7. RELATED PARTY TRANSACTIONS**

- 7.1** Alongside appropriate procedures to identify and manage conflicts of interest, boards should have a robust, independent process for reviewing, approving and monitoring related party transactions (both individual transactions and in aggregate).
- 7.2** A committee of independent directors, with the ability to take independent advice, should review significant related party transactions and aggregate levels of related party transactions to determine whether they are necessary, appropriate and in the best interests of the company and, if so, agree what terms are fair for other shareholders.
- 7.3** The Board should confirm that all related party transactions have been reviewed and approved by the board, or if not how such transactions are monitored. The company should also disclose in its annual report transactions that are significant, whether by virtue of their significance to the business, the individuals involved or the perception of potential conflicts.
- ▶ **Subject to the specific circumstances of a related party transaction, concerns may be expected to arise when they are not:**
    - ▶ subject to proper oversight by the board and regular review (e.g. audit, shareholder approval);
    - ▶ clearly justified and beneficial to the company;
    - ▶ undertaken in the normal course of business;
    - ▶ undertaken on fully commercial terms;
    - ▶ in line with best practice; or
    - ▶ in the interests of all shareholders.

**RESOLUTION 8. APPROVE FINAL DIVIDEND**

**8.1** Companies should have clear dividend policies which set out the circumstances for distributing dividends and returning capital to shareholders. It is important that the financial position, maturity and strategy of the business are appropriately considered and reflected. Dividend policy disclosure should be specific enough to understand what the policy means in practice, including the basis for deriving the proposed level of dividend and specifics of how it is determined. Good disclosure 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.

- ▶ **Investors will form a judgement as to the sustainability and appropriateness of the dividend and vote accordingly.**

**8.2** If shareholder approval is not sought for the approval of the final dividend, investors may wish to consider submitting a shareholder resolution or voting against the company's report and accounts, except where companies can demonstrate that changing their practice to seek shareholder approval of the dividend would significantly delay payment, to the material disadvantage of shareholders.

- ▶ **There should always be a cash dividend available as an option to a scrip dividend or equivalent. If such an option is not available, shareholders may vote against approval of the dividend.**

## RESOLUTION 9. ISSUANCE OF NEW SHARES

- 9.1** Capital governance is a particularly important issue. In accordance with company law, companies must secure shareholder approval to be able to issue new shares. Resolutions allowing the company to issue new shares are normally of two types known as ‘Section 551’ and ‘Section 570’ Authorities.
- 9.2** Sections 551 Authorities allow companies to allot new shares. Any amount in excess of one-third of existing issued shares should only be applied to fully pre-emptive rights issues in order to protect against shareholder dilution.
- 9.3** Section 570 Authorities allow companies to issue shares for cash without the application of pre-emption rights. The maximum allowed under the Pre-Emption Principles is equivalent to 5% of the issued share capital at the time of the Authority. An additional 5% is acceptable provided that, in the circular for the AGM the company confirms that it intends to use it only in connection with an acquisition or specified capital investment which is announced contemporaneously with the issue, or which has taken place in the preceding six-month period and is disclosed in the announcement of the issue. A multi-year limit also applies to issues of shares for cash otherwise than in connection with an acquisition of specified capital investment, typically a maximum of 7.5% of shares to be issued over three years without the application of pre-emption rights. Companies should clearly signal their intention to undertake a non-pre-emptive issue at the earliest opportunity and establish a meaningful dialogue with their shareholders. They should also keep shareholders informed of issues related to an application to disapply their pre-emption rights. Shareholders in turn should review the case made by a company on its merits and decide on each case individually using their usual investment criteria.
- 9.4** When presenting such resolutions:
1. Section 551 and Section 570 Authorities should be separated into two resolutions; and
  2. Section 551 and Section 570 Authorities should be renewed annually.
- ▶ **A vote against would be appropriate where Section 551 and 570 Resolutions (a) are bundled together, or with any other voting issue, (b) are not consistent with Pre-Emption Principles without a satisfactory explanation.**

**RESOLUTION 10. MARKET PURCHASE OF SHARES**

**10.1** Investors are not for the most part supportive of Rule 9 waivers. Waivers are usually sought where a company proposes to institute a share buyback programme in which a large investor or concert party intends not to participate and institutional investors are naturally concerned about the risk of creeping control.

- ▶ **Shareholders would normally vote against the resolution proposing a waiver of Rule 9 of the Takeover Code.**

**10.2** Investors will normally support share repurchases provided local market regulations and relevant shareholder guidance are met. The board should however, demonstrate that the repurchase is an appropriate use of the company's cash resources, this should include providing investors with an understanding of the process used to identify when a buyback is appropriate; the maximum price the company would be prepared to pay; and the hurdle rate in respect of the buyback, linking to the overall capital management framework of the company. In addition any share-price related metrics within executive incentive schemes should take account of such activity.

**10.3** Investors should be provided with summary information on the weighted average cost of shares bought, total cost, and impact on key metrics for buybacks undertaken during the year to enable them to assess the impact.

- ▶ **Shareholders will generally support buy-backs unless they are not supported by cash-flows of the underlying business or introduce excessive and unsustainable leverage.**



## **RESOLUTION 11. AUTHORISING POLITICAL DONATIONS**

**11.1** The Pensions and Lifetime Savings Association opposes the payment of, or facilitation of payment of, political donations as usually understood. However, the broadly drawn legal definition of this term could potentially encompass donations to charities or educational causes. It is therefore common for authorities to be sought on a precautionary basis.

**11.2** It is acceptable to seek authority for a four-year period where the company has no history of making political donations as usually understood. However, where the authority sought exceeds one year, the company should clarify that separate authorisation will be sought at the following AGM should the authorisation be utilised.

- ▶ **A vote against is warranted where a company seeks authority to make political donations, where:**
  - ▶ Political donations as usually understood are not precluded.
  - ▶ No cap is set on the level of donations.

## RESOLUTION 12. ARTICLES

**12.1** Any changes proposed to the company's Articles should be explained. In addition, boards should regularly review the company's Articles, consult with major shareholders on material amendments and make the Articles readily available.

**12.2** Investors will normally wish to support changes to the company's Articles, provided that it is clearly demonstrated by the board that any changes will not detract from shareholder value or materially reduce shareholder rights.

**12.3** Changes to the company's Articles should not be 'bundled' into a single resolution when they cover non-routine matters.

- ▶ **Shareholders may consider voting against changes to the Articles if non-routine changes are included in the same resolution.**

**12.4** Where a company seeks to increase its borrowing powers, a limit should be stated.

- ▶ **Where a material increase in borrowing powers or no limit is proposed, it may be appropriate for shareholders to vote against the proposed change(s) to the Articles.**

## **RESOLUTION 13. SHAREHOLDER RESOLUTIONS**

**13.1** Shareholder resolutions, can encompass a wide range of issues and be requisitioned by parties with a varying objectives. Management should always provide a comprehensive outline of their position on such resolutions and be available to engage with shareholders in order to facilitate an understanding of both the rationale and merits for the resolution.

- ▶ **Shareholders should consider supporting proposals that will protect or further enhance shareholder rights and transparency and is directed towards improving corporate reputation and/or the long-term sustainable success of the company.**
- ▶ **Where a resolution is binding careful consideration should be given to the proportionality of the request.**

## APPENDIX 2: LIST OF RELEVANT WEBSITES

### **Pension and Lifetime Savings Association Corporate Governance and Stewardship website:**

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

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

<http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.aspx>

### **The UK Corporate Governance Code:**

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

### **The UK Stewardship Code:**

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

### **OECD Principles:**

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

### **ICGN Principles:**

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

### **IVIS Guidelines:**

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

### **United Nations Principles for Responsible Investment:**

[www.unpri.org](http://www.unpri.org)

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

<http://uk.practicallaw.com/groups/uk-gc100-investor-group>

### **AIC Code of Corporate Governance:**

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

### **QCA Corporate Governance Code for Small and Mid-Size Quoted Companies:**

[www.theqca.com/shop/guides/70707/corporate-governance-code-for-small-and-midsize-quoted-companies-2013.thtml](http://www.theqca.com/shop/guides/70707/corporate-governance-code-for-small-and-midsize-quoted-companies-2013.thtml)

