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Insights

UK CORPORATE BRIEFING MARCH 2024

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SUMMARY

Welcome to the Corporate Briefing, where we review the latest developments in UK corporate law that you need to know about. In this month's issue, we discuss:

FTSE Women Leaders Review – Year Three

- Reported numbers in this report show steady gains for women in leadership roles but there is still more to do as the Review closes year three of its five-year term.

IA Letter to Remuneration Committee Chairs

- Ahead of the 2024 AGM season and a fundamental review of the Principles of Remuneration, the Investment Association has written to chairs of Remuneration Committees outlining the issues the IA will be considering in their review and the main themes for 2024.

FRC launches review of UK Stewardship Code

- The FRC is reviewing the UK Stewardship Code and is seeking views from all stakeholders on its efficiency in promoting better stewardship outcomes from engagement with issuers across all asset classes.

The need to complete audit reforms

- The CEO of The Chartered Governance Institute UK & Ireland, has written to the government calling for completion of the UK's audit, corporate reporting and corporate governance system reform *"in order to restore confidence to the financial markets and to provide other stakeholders with reassurance*".

New PLSA Stewardship and Voting guidelines for 2024

- The Pensions and Lifetime Savings Association has published its 2024 Stewardship and Voting Guidelines ahead of the 2024 AGM season containing significant changes to address the current economic climate and the increasing risks associated with cybersecurity and AI.

FRC Thematic Review of reporting by UK's largest private companies

- With varying degrees of reporting quality, the FRC encourages companies to consider their findings and expectations in the report when preparing their next annual reports and accounts.

FTSE WOMEN LEADERS REVIEW – YEAR THREE

The FTSE Women Leaders is an independent, business-led initiative set up to build on the work of the Hampton-Alexander and Davies Reviews to increase the number of women on FTSE 350 boards and in leadership teams. Reported numbers in this report show steady gains for women in leadership roles but there is still more to do as the Review closes year three of its five-year term.

Women on Boards:

- FTSE 100 is at 42.6% (up from 40.5% in 2022)
- FTSE 250 is at 41.8% (up from 40.1% in 2022)
- FTSE 350 is at 42.1% (up from 40.2% in 2022)

Women in Leadership: stronger progress has been made at this level (defined as the Executive Committee & Direct Reports) but a significant uplift in appointment rate is needed to meet the December 2025 target of 40%:

- FTSE 100 is at 35.2% (up from 34.3% in 2022)
- FTSE 250 is at 33.9% (up from 32.8% in 2022)

Top 50 private companies (46 responded): the second year of reporting for these companies sees a good increase in the representation of Women in Leadership to 36% with 15 companies at or above 40%. Meanwhile progress for Women on Boards is flat for the year at around 31% which may be explained by more static board structures in private companies and greater polarisation at board level with around a third of the Top 50 private companies performing strongly at 40% women but more than half trailing well below 33%.

The outlook: with sustained effort from those companies within striking distance of the target and significantly increased effort from those still adrift, the FTSE 350 should meet the 40% target for Women in Leadership by the end of 2025. However, there are a number of competing voices with some saying that the progress for women has 'gone far enough'.

IA LETTER TO REMUNERATION COMMITTEE CHAIRS

Ahead of the 2024 AGM season and a fundamental review of the Principles of Remuneration, the Investment Association ("IA") has written to chairs of Remuneration Committees outlining the issues the IA will be considering in their review and the main themes for 2024.

The IA recognise that companies responded effectively to investor expectations on the cost-of-living crisis with salary budgets being focussed on lower paid employees and stronger alignment between shareholders and committees on these issues. This resulted in an 18% fall in dissent for pay resolutions in 2023 compared to the previous year.

The competitiveness of the UK market continues to be debated and UK remuneration plays an important part of this with mixed views from pension funds and their asset managers, international investors and wider stakeholder perspectives. In September 2023, the IA met with nearly 100 FTSE 350 companies to discuss the Principles of Remuneration and three themes were highlighted by companies regarding the competitiveness of remuneration in the UK:

- Need to increase pay opportunities through LTIP grant levels – some companies highlighted the challenges in attracting US executives and competing in the US market and felt that there should be more flexibility to offer higher LTIPs awards to create a competitive remuneration structure;
- Use of hybrid schemes –some companies want to use these which incorporate performance and restricted shares. Global companies currently use these structures for their executives;
- Requirements in the UK Corporate Governance Code ("Code") – the Code has a number of provisions which extend the long-term perspective of directors through remuneration including malus and clawback provisions, increased holding periods and post-employment shareholding guidelines. Although they increase the long-term alignment of executives and shareholders, there is a view that the perceived impact on the value of remuneration received is disproportionate.

A small number of companies are currently consulting on the impact of these issues with their shareholders and investors will assess proposed changes on a case by case basis. In addition, and in line with feedback received from companies and the evolving views of IA members on quantum and hybrid schemes, the IA will be updating the Principles of Remuneration in 2024 to simplify them and ensure they support a competitive market. They also anticipate that remuneration practices will be a key focus for 2024 and given current market conditions, committees should demonstrate how remuneration outcomes are appropriate given the performance achieved during the year as well as how targets for 2024 have been set.

FRC LAUNCHES REVIEW OF UK STEWARDSHIP CODE

The FRC is reviewing the UK Stewardship Code 2020 ("Code") and is seeking views from all stakeholders on its efficiency in promoting better stewardship outcomes from engagement with issuers across all asset classes.

The review will focus on the extent to which the Code:

- supports long-term value creation which drives issuers' prospects and performance;
- creates reporting burdens; and
- has led to unintended consequences (such as short-termism in targets).

The review will be initiated by a targeted outreach around issuers, asset managers, asset owners and service providers to inform a subsequent public consultation after the AGM season. Expected early 2025, the revised Code will be accompanied by an implementation plan to provide current signatories time to respond to any changes.

THE NEED TO COMPLETE AUDIT REFORMS

In 2021 the government published a white paper with large scale proposals to reform the UK's audit, corporate reporting and corporate governance system. However, following concerns around additional reporting requirements raised by businesses, the government withdrew the regulations in October 2023 as part of an effort to reduce red tape. The proposals would have added additional corporate and company reporting requirements to large UK listed and private companies including an annual resilience statement, distributable profits figure, material fraud statement and triennial audit and assurance policy statement.

The CEO of The Chartered Governance Institute UK & Ireland ("CGIUKI"), wrote to the government calling for completion of these reforms and stating that *"the failure to complete reform has undoubtedly contributed to the persistence of the delisting problem which plagues the London markets……………The Government's capricious abandonment of the long-planned White Paper represented a colossal waste of Government time and public money, sent a bad signal about this Government's commitment to responsible capitalism, and left business leaders and investors in a state of uncertainty."*

The CGIUKI has urged the government to make six urgent changes to company law and the regulatory regime:

- The clarification of directors' duties regarding disclosure of information.
- Disclosure of distributable reserves of in scope companies and groups.
- An expansion of the scope of regulation to include all large private companies (using the formula 750:750).

- S271 of Companies Act 2006 (employment of a professionally qualified company secretary) should be extended to apply to all large private companies.
- New powers to direct changes to the entire contents of the annual report and accounts, rather than having to seek a court order.
- New powers to investigate and sanction directors (including directors of large private companies) for breaches of their corporate reporting and audit-related duties and responsibilities.

Although the changes requested by the CGIUKI do not go anywhere near as far as the original package of reforms in the White Paper, it remains to be seen whether these proposals will be supported by businesses who previously highlighted a strong appetite for existing reporting requirements to be simplified.

NEW PLSA STEWARDSHIP AND VOTING GUIDELINES FOR 2024

The Pensions and Lifetime Savings Association ("PLSA") has published its 2024 Stewardship and Voting Guidelines ("Guidelines") ahead of the 2024 AGM season. The Guidelines contain significant changes to address the current economic climate and the increasing risks associated with cybersecurity and AI including:

- **Audit, risk and internal control** – this includes new sections on cybersecurity and AI. The Guidelines recommend that investors encourage companies to explicitly disclose the governance and oversight structures in place to identify and manage cybersecurity risks as well as providing timely reporting of any breaches and the measures taken in response. Similarly, although AI has the ability to generate significant opportunities in the future, it warns that they can also generate risks for businesses including the amplification of discrimination, proliferation of misinformation and privacy violations. The Guidelines recommend, amongst other things, that companies identify their cybersecurity vulnerabilities, have policies in place in case of a cyber-attack, have an appropriate training policy, take a zero-trust approach when selecting AI tools and third-party services and monitor their use of AI.
  - Voting: investors should consider voting against the re-election of a director if there is evidence of egregious conduct attributable to a particular director around the development and deployment of AI;

- **Remuneration** – as in 2023, the PLSA calls on companies to exercise restraint in executive pay during the current economic climate. It also recommends that companies, in line with the 2024 UK Corporate Governance Code, include a description of its malus and clawback provisions in directors' service contracts in the annual report;

- **Capital structure and allocation** – this includes new commentary on dual class share structures ("DCSS") and the significant increase of these type of structures in recent years. The Guidelines include comments from the Investor Coalition for Equal Votes that these types of structures dilute the ability of minority shareholders to effectively hold companies to account and raise important questions for investors concerned about the integrity and operation of capital markets. It is also worth noting that under the FCA proposals for the new listing regime, there will be greater flexibility for these type of structures including removing the current 5 year sunset clause which limits the exercise period for enhanced voting rights.

  - Voting: to address these issues, the Guidelines recommend that investors consider voting against the Governance Committee Chair (or equivalent) if a company has a DCSS without a sunset clause of seven years or less from the date of the IPO; and

- **Social factors** –this new section comments that recent global events like Covid, the Russian invasion of Ukraine and protests movements have helped to create a momentum for engagement with social topics that may have links to pension fund investments and that companies who consider social factors are able to reduce systematic risk, idiosyncratic risk and total firm risk. The Guidelines highlight the creation of the Taskforce on Social Factors for UK Pensions Industry which aims to support pension scheme trustees and the wider pensions industry with some of the key challenges around managing social factors including the identification of reliable data and metrics.

FRC THEMATIC REVIEW OF UK LARGEST PRIVATE COMPANIES REPORTING

The FRC has assessed the annual reports and accounts of 20 UK companies with revenues ranging from £1.5bn up to £24bn and who employ between 1,000 and 145,000 people. Their review highlighted diverse levels of reporting quality. The central message emphasised the importance of transparent and relevant communication of key matters in order to provide readers with decision-useful information.

Their expectations include:

- balanced analysis in strategic reports focused on the elements of development, performance and position that are key for an understanding of the company;

- an explanation of how the company fits into the wider group structure to allow a user to fully understand the context in which it operates;

- an explanation of the nature of each significant financial instrument risk within the company; and

- critical reviews of annual reports and accounts before finalisation to consider, as a whole, whether it is clear, concise and understandable as well as checking for internal consistency and more detailed presentation and disclosure matters.

Companies should focus their efforts on the disclosure of the most significant, complex or judgemental matters and better reporting does not necessarily require greater volume.

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MEET THE TEAM

Benjamin Lee

London

benjamin.lee@bclplaw.com
+44 (0) 20 3400 4260
