

Hot Topics in Corporate Governance and Reporting in the UK and US

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Today's speakers



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Agenda



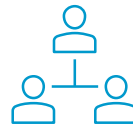
Corporate governance reform and reporting requirements in the UK and US



Pay ratio reporting



Director 'overboarding'



Board diversity



Engagement with stakeholders and employees



Environmental and Social concerns

Corporate Governance Reform in the UK and US



In the UK:

- New 2018 UK Corporate Governance Code
 - Applies to all companies with a premium listing on the LSE regardless of whether they are incorporated in the UK or elsewhere for financial years beginning on or after 1 January 2019
 - Comply or explain approach
- The Companies (Miscellaneous Reporting) Regulations 2018
 - Applies to financial years beginning on or after 1 January 2019
- BEIS consultation on the FRC replacement, the Audit, Reporting and Governance Authority (ARGA)
 - Consultation closed on 11 June 2019
- New Stewardship Code to be published in summer 2019

In the US:

- There have been few changes on the Federal level under the Trump Administration, but:
 - Some bills have been introduced in Congress
 - Some laws have passed on the US state level

Overview of Key Changes in the UK



2018 UK Corporate Governance Code:

- Stakeholders, board leadership and company purpose
 - Significant votes against shareholder resolutions
 - s. 172 statement included in annual report
 - Workforce and stakeholder engagement
- The boardroom – division of responsibilities, composition, succession and evaluation
 - Directors' time commitments
 - Diversity and succession planning
 - Chair not in post for more than 9 years
 - Additional reporting obligations of the Nomination Committee
- Remuneration
 - RemCom should have at least 12 months experience
 - Broader responsibilities for RemCom to review workforce remuneration

The Regulations:

- For quoted companies:
 - CEO pay ratio reporting
 - Enhanced remuneration reporting
- For “large” companies:
 - s. 172 statement in strategic report
 - Engagement with suppliers, customers and other relevant stakeholders
 - Engagement with employees
 - Corporate governance arrangements statement

Overview of Key Changes in the US



On the Federal Level:

- SEC – regulation agenda includes topics such as:
 - Proxy advisory firm and shareholder proposal submission reform; SEC proposals expected by April 2020
 - Short-term vs. long-termism (i.e., whether to streamline the 10-Q/earnings release process)
- Congressional Bills – some pending including:
 - Cybersecurity – Cybersecurity Disclosure Act of 2019 (S. 592)
 - Would require enhanced disclosure on board cybersecurity experience in SEC filings
 - Board diversity disclosure – Improving Corporate Governance Through Diversity Act of 2019 (S. 360 and H.R.1018)
 - If adopted would require enhanced disclosure on board director and executive officer diversity
 - Bills regarding proxy advisory firm reform and climate risk disclosure – introduced in Congress in the last year, but have not advanced

On the State Level:

- California is leading the charge on environmental and social governance issues
- Board diversity
 - California law (SB-826) mandates female directors on boards of all public companies with principal executive offices in the state as follows:
 - At least one by 31 December 2019
 - At least two by 31 December 2021 for companies with 5 board members
 - At least three by 31 December 2021 for those with 6 or more board members
 - New Jersey proposed a similar bill in 2018
 - Colorado, Illinois, Massachusetts and Pennsylvania have adopted nonbinding resolutions encouraging the same
- Climate change disclosure
 - California law (SB-964) requires its 2 largest pension funds, CalPERS and CalSTRS, to disclose climate change risks by 1 January 2020
 - Together, the 2 funds estimated to have over \$400 billion AUM

Hot Topics

PAY RATIO REPORTING



In the UK:

- Required to report the ratio of the CEO's total remuneration to the FTE remuneration of UK employees at 25th, 50th and 75th percentile
- Methodology and presentation prescribed by the Regulations
 - Options A, B or C
 - Nine year look-back
- A number of FTSE 350 companies have already voluntarily disclosed
 - Most have used Option A or indicated they will use Option A
 - For example, AstraZeneca, Marks & Spencer and Unilever
- Links to broader Code provisions on pay

In the US:

- Required to report (i) the median of the annual total compensation of *all* employees, except for the CEO; (ii) the CEO's annual total compensation; and (iii) the ratio of the two amounts
- Methodology and presentation prescribed in Item 402(u) of Regulation S-K
 - Companies have significant flexibility in determining their median employee (e.g., statistical sampling or a consistently applied compensation measure)
 - Generally a company need only identify its median employee once every three years
 - Disclosure is generally required in the company's proxy
- Does not apply to foreign private issuers

Hot Topics

DIRECTOR OVERBOARDING



In the UK:

- Non-executive directors should have sufficient time to meet their board responsibilities
- Prior board approval for external appointments
- 2018 AGM season saw increasing trend of shareholders voting against re-election of a director because of concerns over number of roles
 - For example, Rightmove’s chairman and senior independent director
 - Note recent commentary around Sir Nigel Rudd, chair at Meggitt – stepped down as chair of Destiny Pharma in 2018
- Approach of institutional investors and proxy advisers

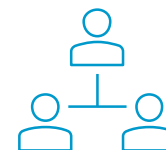
In the US:

- A typical US director for a public company with few or no issues is estimated to spend more than 250 hours a year alone on board responsibilities
- BlackRock, State Street and Vanguard have strict policies on “overboarded” directors
 - In April 2019, Vanguard updated its policy, capping CEOs and the next 4 highly compensated officers at 2 public boards
- Proxy advisory firms will recommend against “overboarded” directors, for example:
 - ISS policy caps CEOs at 3 boards
 - Glass Lewis policy caps CEOs at 2 boards

See the Appendix for further details on the overboarding policies of institutional investors and proxy advisory firms

Hot Topics

BOARD DIVERSITY



In the UK:

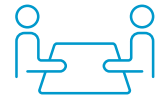
- Boards are encouraged to think broadly about diversity
- Hampton-Alexander Review targets at least 33% of board positions in FTSE 350 held by women by the end of 2020
 - 29% of board positions held by women (up from 12.5% in 2011)
- Parker Review targets at least one director of non-white ethnicity by 2021 for FTSE 100 boards
- Investors have been active in voting against AGM resolutions on the grounds of diversity, particularly lack of gender representation

In the US:

- Topic of considerable focus for US investors, companies, proxy advisory firms and academics
 - Companies are slowly changing
 - Still a large number of Russell 3000 companies that have no female board directors, while 100% of the S&P 100 have had at least one female director
 - Glass Lewis generally recommends a vote against a Nominating Committee chair of a board with no women
 - ISS will enforce the same policy in 2020
- The only SEC guidance this proxy season was on this topic
 - February 2019 staff guidance on enhanced disclosure of board “self-identified” diversity characteristics
 - Definition of diversity covers not only gender and ethnicity/race, but also religion, disability, sexual orientation and cultural background

Hot Topics

EMPLOYEE ENGAGEMENT



In the UK:

- Recommended to use a director appointed from the workforce, a formal workforce advisory panel or a designated non-executive director to engage with workforce
- 83% of FTSE 350 companies already disclose some form of employee engagement mechanism
 - Small number of companies already use a designated NED (for example, Rolls-Royce) or workforce advisory panel (for example, Aviva)
 - Others have recently adopted engagement mechanisms for early compliance with the Code (for example, RBS)

In the US:

- No current push to have a director represent the workforce
- Investors and the SEC, however, are increasingly focused on human capital management (HCM), which is broadly defined as workforce retention and talent management
 - BlackRock announced that HCM would be a key corporate engagement topic in 2019
 - The SEC has hosted roundtables on the topic of HCM disclosure requirements

Hot Topics

STAKEHOLDER ENGAGEMENT



In the UK:

- Board should understand views of key stakeholders and describe how their interests and the matters in s172(1) have been considered
 - 11% of FTSE 350 annual reports mention s172 duty (up from 1% of 2016 annual reports)
- 86% of FTSE 350 identify stakeholder groups beyond shareholders
 - 65% disclose methods used to engage with such stakeholders
 - 69% identified stakeholders in a single disclosure only
 - However, increasingly common to include more extensive disclosure (for example, AstraZeneca and Rolls-Royce)

In the US:

- No direct corollary, but some key takeaways
 - US public company issuers tend to view it as *shareholder* engagement (not stakeholder), but there is the increasing focus on community, customer and global impact is gaining traction
 - As for shareholder engagement, US public companies regularly engage with their shareholders proactively as well as reactively, on remuneration, performance and environmental and social topics
 - The larger the company, the more engagement we have seen

Hot Topics

ENVIRONMENTAL AND SOCIAL CONCERNS



In the UK:

- Board should promote the long-term sustainable success and company should contribute to wider society
- New annual streamlined energy and carbon reporting regime (SECR)
- Proposed Stewardship Code refers to ESG factors
 - Signatories are expected to take material ESG issues into account when fulfilling stewardship responsibilities
- Investors lobbying and voting against resolutions (for example, LGIM against Whitbread and Shell)
- BP shareholder resolution on reduction of carbon emissions

In the US:

- As a result of “private ordering”
 - Approximately 86% of S&P 500 companies are now publishing sustainability reports, as compared to ~20% in 2011
- E&S groups are using the shareholder proposal process to have resolutions voted on at annual meetings – most popular topics this proxy season include:
 - Political contributions and lobbying disclosure
 - Climate change issues including linking carbon targets to compensation metrics
- Climate Action 100+, an international group of investors, has extracted significant concessions from companies regarding climate change targets and climate/comp metrics

Appendix



Investor and Proxy Advisory Firm Priorities

VOTING POLICIES – OVERBOARDING

Proxy Advisory Firms

	ISS	Glass Lewis (**)
CEO (*)	Capped at 3 public boards	Capped at 2 public boards
Named Executive Officer (*)	No Stated Policy (but by inference capped at 5 public boards)	Capped at 2 public boards
Executive Officer (*)	No Stated Policy (but by inference capped at 5 public boards)	Capped at 2 public boards
Other Directors	Capped at 5 public boards	Capped at 5 public boards

Institutional Investors

	BlackRock	State Street	Vanguard
CEO (*)	Capped at 2 public boards	Capped at 3 public boards	Capped at 2 public boards
Named Executive Officer (*)	Capped at 4 public boards	Capped at 6 public boards	Capped at 2 public boards
Executive Officer (*)	Capped at 4 public boards	Capped at 6 public boards	Capped at 4 public boards
Other Directors	Capped at 4 public boards	Capped at 6 public boards	Capped at 4 public boards

* The number of boards shown in these rows includes the board of the company at which s/he holds such title

** Glass Lewis considers mitigating circumstances

Reporting Requirements under the UK Regulations

	Private companies and public companies that are not quoted				Quoted companies ¹		
	Medium* ²	Large ³ (250 or fewer UK employees) ⁴	Large ³ (more than 250 UK employees) ⁴	Very Large ⁵	Medium* ²	Large ³ (250 or fewer UK employees) ⁴	Large ³ (more than 250 UK employees) ⁴
CEO pay ratio report					X		X
Remuneration reporting					X	X	X
s172(1) statement in strategic report		X	X	X ⁶	DTRs / LRs	X	X
S172(1) statement on website		X	X	X			
Stakeholder engagement statement		X	X	X ⁶	DTRs / LRs	X	X
Employee engagement statement	X		X	X ⁷	X		X
CG arrangements statement (in strategic report and on website)				X	DTRs / LRs	DTRs / LRs	DTRs / LRs

¹ “Quoted companies” – UK-incorporated companies that are quoted on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the EEA. Not AIM traded companies.

² “Medium*” – a company that must produce a strategic report and is not a Large company but has more than 250 UK employees in its group.

³ “Large” – a company that meets two out of three of the following:

- turnover of more than £36 million
- balance sheet total of more than £18 million
- more than 250 employees.

⁴ If it is a parent company, it is the number of UK employees in its group.

⁵ “Very Large” – a company not required to provide a corporate governance statement under DTR 7.2 and having more than 2,000 employees and/or a turnover of more than £200 million and a balance sheet total of more than £2 billion. Quoted companies that are Very Large but are not required to provide a DTR 7.2 statement will need to comply with the CG arrangements statement obligation.

⁶ Very Large companies will only have to comply with this requirement if they are also Large.

⁷ Very Large companies will only have to comply with this requirement if they have more than 250 UK employees (if the company is a parent company, it is the number of UK employees in its group).