CLIFFORD CHANCE

Briefing note January 2012

AGM Update: 2012

Good news! After numerous developments in recent years, there are no major changes in AGM and reporting practice for 2012.

However, the impact of the financial crisis continues to be felt and focus remains on areas that are perceived to have contributed to it. Executive pay, board effectiveness, corporate reporting and investor engagement all remain under the spotlight.

This Update highlights hot topics for the 2012 AGM, recent and upcoming changes in financial reporting, and the most recent corporate governance developments.

AGM Update

Clamping down on executive pay

Executive pay remains highly sensitive. Press reports indicate that investors are closely monitoring increases in directors' remuneration and whether those increases are clearly linked to company, and individual, performance.

Scrutiny is particularly intense in light of research showing that total earnings for FTSE 100 directors rose by an average of 49% in the 2010/2011 financial year.[1] Intensifying pressure in the banking sector, the ABI took the unprecedented step in December of writing to the chairmen of the UK's five biggest banks, warning of conflict with major investors unless there is a fundamental change of approach to executive pay and bonuses.

Mirroring public sentiment, a number of reviews and guidelines have been published over the course of the year, focusing on ways to ensure that pay is matched to performance and long-term success. And now, the Government has outlined its much-anticipated proposals on executive pay, which will see greater transparency in reporting and increased shareholder influence and control over executive pay. The full detail of the proposals will not be known for some weeks and is not expected to impact this year's reports or AGMs. Our upcoming January 2012 Corporate Update will contain a description of what is expected.

For now, details of directors' remuneration must be disclosed in the directors' remuneration report and a statement included of how pay and employment conditions of employees within the group were taken into account when setting directors' remuneration. A listed company is required to put the remuneration report to a vote each year. At present, the vote is advisory only - although the Government has announced its intention to give shareholders a binding vote on some elements of pay policy. Even so, the vote is already an important tool for shareholders to express their views on the company's remuneration policy.

Editor Comment

Last year's AGM season witnessed a series of shareholder revolts over executive pay. A number of companies saw a significant percentage of shareholders expressing dissatisfaction over executive pay and awards by voting against the remuneration report. Based on current investor sentiment and press reports, this seems likely to continue into the 2012 AGM season. Listed companies should expect to be watched: not only for significant percentages of "no" votes, but also for sizeable numbers of abstentions which may be intended as a warning to the company.

[1] *Income Data Services press release, 26 October 2011.*

Reminder: Corporate Governance Code in force

A reminder that the Corporate Governance Code is now in effect for all listed companies, having replaced the Combined Code for financial years starting on or after 29 June 2010.

Although the new Code applies for the first time to this AGM and reporting season, a significant number of FTSE 350 companies chose to apply some or all of it last year.

ABI guidance on authority to allot

The guidance on directors' powers to allot share capital and disapply pre-emption rights issued by the ABI in December 2008 is due for review following its initial three years of operation. While no new guidance has been issued to date, we understand that the ABI does not intend to change the substance of the current guidance – viz. that it is routine for a company to seek authority to allot a further one-third of its share capital in connection with a fully pre-emptive rights issue.

The existing ABI guidance can be found at: http://www.ivis.co.uk/ShareholdersPreemptionRight.aspx

Annual re-election of directors

The Corporate Governance Code now provides that all directors of a FTSE 350 company should be put forward for re-election each year. Following the "comply or explain" principle, a company will need to provide a clear explanation in its annual report if the full board is not subject to annual re-election at the 2012 AGM.

This provision was the most controversial aspect of the Code when it was introduced in 2010. Concerns were expressed that annual re-election would destabilise boards and lead to short-termism. Last year, despite these concerns, 80% of the FTSE 350 put the entire board up for re-election, even though the Code requirement was not yet in force. We expect almost all FTSE 350 companies to comply in 2012.

Annual re-election of all directors is widely supported by investor bodies. Both the ABI and NAPF support annual re-election of directors of FTSE 350 companies. PIRC goes one step further and recommends that all listed companies should hold full elections each year.

IN NUMBERS: At 2011 AGMs, percentage of the FTSE 350 that…	
...proposed a resolution to permit general meetings to be called on less than 21 days' notice...	87%
...proposed an authority to allot an additional one third of share capital…	65%
...proposed resolutions to re-elect all directors...	80%
...used automatic poll voting on all resolutions...	41%
...provided webcast broadcast of/participation in the AGM...	3%

Do I need to take any other steps if the full board is being put forward for re-election?

Annual re-election of all directors is unlikely to require changes to articles of association. Very few companies made any changes last year. However, when next amending its articles, a company may wish to take the opportunity to:

- remove outdated retirement by rotation provisions; and
- provide for the (unlikely) scenario that not enough directors are re-elected to meet the minimum number of directors required by the articles.

A company may also wish to review its directors' appointment letters and service contracts to ensure no adverse impact is caused by annual re-elections.

Financial Reporting Update

Women on boards: new annual report disclosures

The February 2011 Report, "Women on Boards", authored by Lord Davies acknowledged the low numbers of women on FTSE 350 boards and made a number of recommendations aimed at a voluntary increase.

The recommendations included requirements for listed companies to disclose boardroom diversity policies, targets for the percentage of women on the board, and the current percentage of women on the board, in senior executive positions and across the group as a whole. Responding to the call, the Financial Reporting

Which Davies Report disclosure recommendations should I consider this year?

Aspirational targets: The Davies Report called on chairmen of FTSE 350 companies to announce by September 2011 the percentage of women that they aim to have on their boards in 2013 and 2015. Companies are encouraged to report on this target progress in their 2012 Corporate Governance Statements.

Boardroom diversity: The Corporate Governance Code is being amended to require a listed company to:

- report annually on the board's policy on diversity (including gender), any measurable objectives that the board has set for implementing the policy and progress against those objectives; and
- consider diversity of the board (including gender) when evaluating the board's effectiveness.

The changes are intended to take effect on 1 October 2012. However, the FRC "strongly encourages" listed companies to apply these changes with immediate effect.

Proportion of female representation: BIS is consulting on changes to the narrative reporting regime that will require a listed company to disclose each year the proportion of:

- women on the board;
- women in senior executive positions; and
- (to the extent data is available) women in the whole organisation.

These changes are also intended to take effect on 1 October 2012.

Council ("**FRC**") and the Department for Business, Innovation and Skills ("**BIS**") initiated consultations to enshrine these disclosures in regulation and legislation. Although not yet in force, companies wishing to be proactive on gender diversity might consider making such disclosures in this year's annual report (see opposite box for details).

According to a six month progress update in October 2011, 22.5% of FTSE 100 board appointments and 18% of FTSE 250 board appointments between March 2011 and October 2011 were of women.[2] Although this is still some way short of the Davies Report's 33.3% target for all new appointments from March 2011, it may herald an acceleration of progress.

The Davies Report can be found at: http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

An improvement in the quality of corporate reporting

In its annual report, published in September 2011, the Financial Reporting Review Panel ("**FRRP**") found the general quality of corporate reporting to be good.

The FRRP reviewed 301 annual reports in the year to 31 March 2011, focusing on narrative reporting. It noted widespread improvement in the description of principal risks and uncertainties and of the actions of boards to mitigate their effects.

The FRC has echoed the FRRP's findings, indicating that the overall standard of corporate reporting has improved, with many annual reports showing real insight into how a company is run.

The FRRP annual report can be found at:

http://www.frc.org.uk/images/uploaded/documents/FRRP%20Annual%20Report%202011%20final.pdf

How to further improve corporate reporting

The FRRP considers that further improvements can be made:

- Provide clearer and more informative explanations where a company has departed from the Corporate Governance Code. The FRC is consulting with companies and investors about the type of information that should be provided to make explanations useful to shareholders, with a view to incorporating it into the Code.
- When disclosing principal risks and uncertainties in the business review, identify events that have a low likelihood of occurring, but which would have a high impact if they did happen.
- Ensure that the business review is presented in a fair, balanced and comprehensive way, including, for example, bad news and setbacks as well as good news and advances.

The FRRP notes that there have been instances where a failure to make required disclosures in the business review has been defended on grounds that the information was already publicly available, through, for example, a RNS announcement. The FRRP warns that this is not an acceptable excuse.

[2] *Women on Boards 6 Month Monitoring Report, Cranfield School of Management, October 2011*

The FRC's report can be found at: http://www.frc.org.uk/images/uploaded/documents/Developments%20in%20Corporate%20Governance%2020116.pdf

Looking ahead...

BIS is currently consulting on the future of narrative reporting, with a view to simplifying the structure and content of narrative reports.

The FRC has signalled its intention to amend the Corporate Governance Code in relation to audit processes. Changes to the "going concern" statement are under review in light of the Sharman Panel's preliminary recommendations published in November 2011. In addition, the FRC intends to update its guidance notes on audit committees, and risk management and internal control.

The good news is that these reviews will not affect the 2012 AGM nor this year's annual report. Any changes are expected to be published in the first half of 2012, to take effect for financial years starting on or after 1 October 2012. So, for a listed company with a calendar year end, the new framework would apply to the financial year ending 31 December 2013.

Please see our upcoming January 2012 Corporate Update for further details of these reporting reviews.

Corporate Governance Update

Updated corporate governance and voting guidance

NAPF and PIRC have issued updated corporate governance guidelines. Broadly, the updated guidelines focus on addressing the continuing effects of the financial crisis through, for example, board effectiveness and shareholder engagement.

NAPF: Corporate Governance Policy and Voting Guidelines

The November 2011 NAPF Guidelines remain largely unchanged from the 2010 version. The few amendments include:

- *Gender diversity*: NAPF expects boards to set out a policy for achieving more diversity on the board and to track implementation of that policy; and
- *Stewardship Code*: NAPF sees the Stewardship Code as an important step to improving dialogue and oversight. It expects pension funds and other asset managers to state their support for the Stewardship Code publicly and to disclose the extent to which they comply with its principles.

The NAPF Guidelines can be obtained from the NAPF website at: http://www.napf.co.uk

PIRC: Shareholder Voting Guidelines

In March 2011, the 15th edition of the PIRC Guidelines were published. The changes from the 2010 version are wide-ranging and cover board matters, remuneration, audit and reporting, auditors, shareholders' rights and corporate actions.

Some of the more topical changes include:

- *Re-election of directors*: PIRC believes that annual re-election of directors should not be limited to FTSE 350 companies;
- *Board evaluations*: PIRC believes that the Corporate Governance Code requirement for externally facilitated board evaluations every three years for FTSE 350 companies should be extended to the remainder of the FTSE All Share;
- *Remuneration clawback*: PIRC supports the introduction of binding provisions enabling companies to clawback bonuses (and other variable remuneration), where relatively poor performance for the award period becomes apparent at a later date; and
- *Shareholder relations*: PIRC expects companies to disclose the agendas (or, at least, topics) of meetings that have taken place over the previous year between directors and shareholders or shareholder advisory bodies.

The PIRC Guidelines can be obtained from PIRC's website at: www.pirc.co.uk

Stewardship Code: take-up and impact

The FRC issued its first report on the impact and implementation of the UK Stewardship Code in December 2011. Since implementation in July 2010, the Stewardship Code has attained 234 signatories, including asset managers, asset owners and service providers. While the FRC noted that it could not yet declare victory in its quest to achieve better engagement between institutional investors and companies, it believed that the level of take-up indicates a "real commitment to making the code-based approach work effectively".

From its review of the statements issued by the signatories to the Stewardship Code, the FRC identified four areas for improvement:

- weak reporting on management of conflicts of interest between the signatories' own interests and those of their clients;
- statements regarding collective engagement were too focused on membership of collective bodies rather than on joining forces with other investors;
- lack of detail regarding the use of proxy voting agencies; and
- lack of contact information for raising queries.

The FRC noted that views of companies towards institutional investors, and vice versa, are still mixed. From a company perspective, institutional investors still have some way to go to integrate their investment and corporate governance functions properly. From an investor perspective, some companies tend to ignore significant "no" votes if there is still a majority in favour.

Acting as barriers to effective stewardship, the FRC highlighted shareholders' lack of resource and a reluctance to become too engaged with management for fear of being treated as acting in concert or being made insiders.

From its review of the take-up and impact to date, the FRC proposes to make limited, clarificatory revisions to the Stewardship Code. The FRC also hopes to stimulate discussion around performance metrics to use to measure the impact of the Stewardship Code.

The FRC's report can be found at: http://www.frc.org.uk/images/uploaded/documents/Developments%20in%20Corporate%20Governance%202011 6.pdf

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