GOVERNANCE

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What price climate change?

'A lack of consistent financial evaluation of the timing and scale of climate change impacts was cited as a barrier by several respondents – and this was linked with another barrier, the perceived gap between the long-term effects of a warming climate and a much shorter-term focus to most boardroom discussions.'

David Archer and Alex Cameron

Shareholder engagement

'As US-based investors build out their engagement teams in Europe and beyond, and European-based investors grow their presence in the US, a continued cross-pollination of engagement themes and styles is a likely result. Being able to adroitly navigate the shifting landscape will be a defining challenge for companies and boards in the years ahead.'

Bob McCormick and Rob Zivnuska

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Executive pay 2018: FTSE 100 review

'The average FTSE 100 CEO pay package increased by 11% between 2016 and 2017, despite prominent criticism from the investor community and the Government over excessive CEO pay awards in the past year', according to analysis by the Chartered Institute of Personnel and Development (CIPD) and the High Pay Centre.

The Report, *Executive pay: review of FTSE 100 executive pay*, examines how FTSE 100 chief executives are rewarded, examining aspects of remuneration such as salaries, bonuses, long-term incentive plans and benefits. It lists CEO pay data by mean and median, industrial sector, firm size and gender. It also makes recommendations for stakeholders interested in creating a fairer and more ethical approach to employee reward.

Pay ratio

CEO reward increases outstrip pay rises for the wider workforce. Despite the push for greater pay transparency and the forthcoming introduction of pay ratio reporting, the median remuneration among FTSE 100 CEOs was £3.93 million in 2017 and the analysis found that the ratio between the mean pay of CEOs and their employees was 145:1. Only 34 FTSE 100 companies are accredited by the Living Wage Foundation for paying the living wage to all their UK-based staff.

Mean and median CEO remuneration

This year's analysis is affected by two very large payouts for the CEOs at Persimmon and Melrose Industries (£47.1 million and £42.8 million respectively). As a result of this, this year's Report leads with the median, rather than the mean figure. Using the *median* measure of CEO remuneration reduces the impact of these two payouts, but it still shows an increase in earnings of 11%, compared to the 2% rise in median pay for full-time workers over this period. However, if the *mean* measure is used, then it shows that CEO mean pay across all FTSE 100 companies has increased by 23% over the same period to £5.66 million in 2017. Excluding Persimmon and Melrose Industries from the analysis would see the 2017 mean CEO single figure fall to £4.85 million. However, this is still higher, by 6%, than last year's overall mean figure of £4.58 million, showing a continued underlying trend of rising executive pay.

Other highlights

The highest paid CEO in the financial year ending 2017 received £47.1 million, 22 times his 2016 pay. Just seven FTSE 100 CEOs are women, an increase from six in 2016 and five in 2015. At the current rate of one new female CEO each year it will take another 43 years for women to make up 50% of the FTSE 100 CEOs. While women make up 7% of FTSE 100 CEOs, they earn just 3.5% of total pay.

Recommendations

To advocate fairer and more ethical approaches to pay and reward, rather than waiting for the mandatory pay ratio reporting requirement coming into force in 2019, companies should introduce it immediately, supported by a clear narrative. They should provide clearer information about wider pay distribution within their organisations – guidance from regulators or professional associations could help ensure consistency in this respect – and policy-makers and companies should review whether existing remuneration report content, aside from pay levels, pay distribution and performance-related pay metrics, is of value to stakeholders, with the objective of reducing the length and complexity of reports.

Remuneration committees must look at top pay in the context of the organisation's overall reward strategy to ensure a fairer alignment and proportionality for top pay. They should challenge for evidence on how pay and bonuses impact individual performance and how much performance is due to an individual's efforts or if they fall in a wider economic context. In particular, they must properly examine traditional mechanisms like bonuses and long-term incentive plans. Remuneration committees and shareholders should place stronger emphasis on ensuring CEO reward is aligned with pay practices throughout the organisation and that CEO performance is assessed by non-financial, as well as financial, measures, including investment in workforce training and development and indicators of employee satisfaction and well-being.

Since the previous annual review of FTSE 100 chief executive remuneration, the level of structure of CEO reward has continued to be a central theme of wider debates about corporate governance, economic inequality and prevailing workplace culture and employment practices. In this year's Report, the finding that chief executive pay has increased will no doubt spark further controversy. A further report will be published by the CIPD and the High Pay Centre later this year which will examine how the remuneration committee can be reformed to deliver better outcomes on pay – for low, middle and top earners – from the perspective of all stakeholders.

For the full Report go to: www.cipd.co.uk/knowledge/strategy/reward/executive-pay-ftse-100-2018

International

Disability and the role of the board

'With disability affecting 15% of the world's population, forward-thinking organisations are already building a more inclusive future', according to a recent report. Published by KPMG and Purple (a not-for-profit that works with business on disability inclusion), the Report, *Leading from the front: disability and the role of the Board*, is the first review of its kind looking at the current research and best practice in the field of disability, one of its three main areas of focus is the influence of corporate governance.

Disability affects approximately one billion people and faced with talent shortages and the socio-economic costs of an ageing population, more companies are re-evaluating the contribution disabled people can make. Increasing diversity, including disability, at board level and throughout the workforce is one clear way that companies can access a wider pool of experience.

A number of different mechanisms are already being explored, including employee representatives on boards, assigning a named director responsible for understanding the workforce and running employee forums that are attended by directors. By exposing boards to a greater volume and variety of insights from workforce, the aim is to create more opportunities for diversity issues to be raised at the highest levels.

Investor attitudes

Key stakeholders are taking a stronger interest in diversity – and disability in particular. The FRC has consulted on proposed changes to its corporate governance code that will make boards more accountable for corporate culture, including diversity and stakeholder engagement, and there is stronger emphasis on sustainable and socially responsible investing, led by some of the world's largest institutional investors. Diversity is becoming a bigger priority for investors too and evidence is emerging to suggest that organisational diversity can deliver better returns for investors. Leading global investors are expanding their corporate governance teams to support their shift in emphasis to sustainable investment practices.

Board best practice

Diversity at the board and senior leadership levels has been a hot topic for a number of years now. A company stands a better chance of staying connected to their customers and communities if their leadership can draw on the broadest possible range of experiences. Forward-thinking leaders and organisations are already building a more inclusive and prosperous future in which the potential of disabled people can be fully realised. Boards can play a pivotal role in helping their organisations by taking the following steps.

1. Put disability on the agenda for board meetings, for a minimum of one board meeting each year. Before deciding on a course of action there needs to be a detailed discussion about what the approach will be.
2. Appoint a board-level champion who is accountable for disability issues within the organisation. This will help ensure that ideas and initiatives are followed through, especially when input is required from multiple departments and functions, and also demonstrates to staff that the organisation takes these issues seriously.
3. Sign up to the Government's Disability Confident scheme to demonstrate commitment to becoming an inclusive employer and brand. Since Disability Confident was formally launched in November 2016 over 5,000 employers have signed up to the scheme at different levels.
4. Become an advocate and promoting disability issues to suppliers, extended networks and external audiences. The board can inspire others to follow suit. If organisations already employ disabled people, tell company networks how good it is for business and how it can work within organisations.
5. Consider external partnerships with campaigns and bodies that specialise in disability issues to develop understanding and accelerate change programmes. The right specialist support can help organisations navigate potentially tricky first conversations and get the right policies in place from the very start.

A better future for disability

Though disability should be considered within the broader term of 'diversity', there is still work to do in encouraging those concerned with corporate governance to focus on disability issues. It is unclear whether wider social impact reporting, including specific metrics on disability, will become mandatory in future (outside of gender pay gap reporting). The next step is to move from acceptance to actively embracing disabled people and the contributions they can make in and out of the workplace with a vision for the future where: disability is part of every company's customer service training programme; the vast majority of disabled employees share their disability status with their employer; working alongside disabled colleagues has become so normal it is unremarkable; and most people can name a chief executive with a known disability.

For the full Report go to: https://bit.ly/2oRLFIM

Global News

Technological innovation and corporate governance

The Thought Leadership Committee (TLC) of International ICSA has recently published a paper *Future Proofing: Technological innovation, the company secretary and implications for corporate governance*. Technology is transforming how businesses operate and it is the board's role to ensure that they are shaping their organisations to be fit for the future.

New technology will affect corporate governance professionals in two fundamental ways: by increasingly changing the way they work; and by giving rise to new corporate governance challenges, eg transparency, fairness and ethics. Organisations need to understand what technologies are available, how they work and the strengths and limitations of each. Artificial Intelligence (AI) gives rise to governance issues of deployment, control and risk and organisations will have to put in place governance mechanisms and codes of practice and procedure.

AI is already being deployed in boardrooms to help directors make decisions and technology to analyse and interpret data quickly and accurately already exists and could be deployed in the boardroom to enable better decision-making. If AI can more reliably and accurately interpret data and make better predictions than humans, shareholders and stakeholders will want to see it used. However, legislators and regulators will need to examine what measures are required to ensure that AI remains under board oversight.

The use of AI raises both practical and ethical governance questions. Many organisations are looking at the ethics of AI use and governments and regulators will, in time, look to introduce new legislation, codes of practice and sector-specific guidelines to deal with the ethical and risk and control issues stemming from AI. Boards should monitor this, consider the likely impact on their organisation and help formulate good governance practice internally.

Various studies have shown that some 60% of a company's value may not now appear on its balance sheet; this 'hidden' value is in the form of intangible assets such as IT, intellectual property, branding, reputation, customer lists and employee engagement. The ability to be more agile, customer-facing and transparent will drive the development of AI solutions and this will be true of boardroom products and services too. It is critical for governance professionals to improve their understanding of the new technologies and their implications.

For the full paper go to: https://bit.ly/2Nt9jJK

Hong Kong CG Code update

The Hong Kong Stock Exchange (the Exchange) has published new measures as a result of consultation on its Corporate Governance Code (CG Code) and related Listing Rules along with guidance for boards and directors. The following new measures will be implemented:

Strengthen the transparency and accountability of the board and/or nomination committee and election of directors, including Independent Non-Executive Directors (INEDs). The amended Rules will enhance the transparency of the INED appointment process and empower shareholders with more information about INED candidates, including their time commitments due to any current board responsibilities and their potential contribution.

Improve transparency of INEDs' relationships with issuers by including in the Corporate Governance Report an INED's cross-directorships or significant links with other directors.

Enhance criteria for assessing independence of potential INED candidates by extending the cooling off period for persons with material interests in the business activities to one year; for former professional advisers to two years; for former partners of the issuer's audit firm before they can be a member of the organisation's audit committee to two years; and include a person's immediate family members in the assessment of the proposed INED's independence. Other measures include promoting board, including gender, diversity and requiring greater dividend policy transparency.

The Exchange has also published *Guidance for Boards and Directors* to help directors carry out their role more effectively: the Guidance does not form a part of the Listing Rules nor does it amend or vary any Rule requirements. The new publication contains practical advice to boards and directors on their roles and responsibilities and covers directors' duties and board effectiveness, board committees, board diversity – including gender diversity – and corporate governance for weighted voting rights issuers. The Guidance also encourages successful listing applicants to appoint INEDs at least two months prior to listing.

The 'comply or explain' provision has been updated and now requires issuers to have a diversity (in its broadest sense) policy and to disclose the policy or a summary of the policy in the issuer's corporate governance reports. The new measures will take effect on 1 January 2019 through amendments to the CG Code and related Listing Rules.

Feature

A cross-sector approach to governance

Tony Breslin and **Cosette Reczek** make the case for a cross-sector Better Governance Commission.

Vanessa Jones' discussion of the Wates Principles in the July 2018 edition of *Governance* provides a valuable summary of the trends, tensions and opportunities facing those who are active in the world of corporate governance: issues of purpose, composition, responsibility, risk and remuneration; definitions of who counts as a stakeholder and, more pertinently, just how close he or she should sit to the governance table and just how involved they should be in governance processes.

Commonalities across the sectors

But these issues are not exclusive to those involved in the governance of our larger businesses and corporations. These same themes resonate with those in governance across sectors and in organisations of very different size, composition and purpose: on school governing boards, across the voluntary sector and in the delivery of our public services.

Exploring just how strong these commonalities might be has been the subject of a series of cross-sector roundtable discussions – launched in March and set to run through to December 2018 – hosted, to date, by a diverse range of organisations and their sponsoring partners across the governance landscape: the Institute of Directors, the public sector-focused National Executive Academy, the National Council for Voluntary Organisations, the housing consultancy Campbell Tickell, and the National Governance Association, which represents school governors.

The idea for the roundtables emerged from a recommendation in a recent, well-received report into the future of school governance, of which one of us was the author. *Who Governs Our Schools? Trends, Tensions and Opportunities,* was published by the RSA in September 2017 and launched in Parliament at that month's meeting of the All Party Parliamentary Group on School Governance.

The Report, and the 18-month scoping study that preceded it – which was funded by the Local Government Association, the Elliot Foundation and RSA Academies, with additional support from the Association of School and College Leaders, the Catholic Education Service, the Centre for Public Scrutiny and the National Governance Association – had stimulated initial discussion with those interested in governance outside the education sphere, while concurrent developments in these sectors, such as the establishment of the Wates Review, underlined a wider concern for governance issues.

Shared concerns

Over the past decade this wider concern has been stimulated and continually reinvigorated by a recurring news agenda that has highlighted very public examples of governance failure: from RBS to BHS, from Kids Company to Save the Children, from Wakefield City Academies Trust to Oxfam, from the Co-operative Group to Carillion, from Rotherham to Rochdale, and from the Trojan Horse to Mid-Staffordshire NHS Foundation Trust. In each of these (often very different) cases, one theme has appeared pervasive: the optic of an *apparent* failure of governance. Meantime, multiple examples of high quality, professional and committed governance, as celebrated in these pages and in a range of largely sector-specific journals, remain unacknowledged beyond their particular communities, with the lessons from these successes remaining locked within sector-specific and sub-sector specific communities.

Recommendation 29

Against this background, those working on *Who Governs Our Schools?* became increasingly aware that there might be merit in unlocking the doors to these communities, and that many of their recommendations – although focused on the shifting terrain of school governance – might have a pertinence to other sectors and areas of activity. Crystalising this, Recommendation 29 of the Report reads:

> 'Agencies across the governance landscape need to work together to establish a cross-sector working group or Commission on Governance' (#R29)

At the turn of the year, Ann Reeder at Frontline Consulting, who has led efforts to establish the Non-Executive Academy, the association for non-executives based in organisations committed to the delivery of public services, offered to support efforts to make this kind of cross-sector working a reality and the #R29 campaign, committed to building the case for such a commission was born, launched at a roundtable, hosted by the NEA and sponsored by Frontline, in Parliament.

As with the subsequent roundtables, we have attempted to focus discussion on three questions, designed essentially to test the hypothesis that underpins Recommendation 29 and the case for a commission:

1. To what extent can those involved in governance across the sectors, particularly as non-execs and trustees, learn from each other?
2. What benefits might accrue from such learning and how might we facilitate this sharing of insight and experience?

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3. Can we identify a set of sector-agnostic key principles that should inform governance, scrutiny and accountability, whatever the sector, organisational type and focus of activity and, if so, how might we go about this task?

Initial themes

In truth, our discussions have been wider ranging, not least because each roundtable has drawn individuals not only with a sectoral interest but also from a wide range of backgrounds and, in some cases, governance responsibilities in various settings – as company directors, as the trustees of charities, as school governors, or as members of NHS Trusts. Thus, a robust range of key themes and challenges are emerging; here, we have elected to highlight six:

1. That each sector faces specific challenges in terms of widening participation, and extending and evidencing diversity, and that each sector might improve its practice by exposure to the practice of those in other settings;
2. That, in some settings, well-intended attempts to 'professionalise' governance can serve to weaken the 'connectedness' between governance boards and those they serve, *intentionally* strengthening governance in one respect while *unintentionally* weakening it in another;
3. That the interplay between those involved in governance roles and those who hold executive responsibilities is a much more nuanced relationship than represented in the literature and in induction and development programmes for non-execs, trustees, school governors and others who hold governance responsibility or who report to governance boards;
4. That, within our organisations and across our stakeholder communities, governance-literacy beyond the boardroom is often low, with the purpose and efforts of those who serve as directors or trustees or governors routinely misunderstood, sometimes the subject of caricature and often unacknowledged;
5. That, at a time when many citizens feel disconnected from, and mistrustful of, the political sphere, a similar disconnectedness from, and mistrust of, those involved in governance would represent a 'double-whammy' not just for the effectiveness of our organisations, but for the health of our democracy and our society – in the corporate world, this trust deficit has the potential to impact negatively on the bottom line while obscuring positive interventions, for instance in the sphere of corporate responsibility;
6. That governance within each sector and sub-sector is marked by particular qualities, requirements, and expertise in addition to the universal common core of corporate governance activities and boardroom behaviours – the resultant diversity of practice across the sectors opens up learning opportunities and the prospect of newly shared insights inside and outside our boardrooms, whatever their setting or sector.

A Better Governance Commission?

Our central proposition is that these challenges are best addressed by sharing experience and expertise across the sectors, a process that itself promises to enhance governance literacy and build, or rebuild, trust in governance. Our roundtables, delivered by volunteers and hosted without charge, have begun to identify some of the big issues, but we now require a much more rigorous investigation into the kind of issues that we have identified above, an investigation that a properly resourced and formally established Better Governance Commission could address.

Our efforts are now focused on securing the funding, organisational, media and political support to establish such a commission, launching in early 2019 and reporting 12 months later. How we exercise governance in our corporations, our hospitals and schools, and our charities is too important to be left to chance, while any sector-specific review is likely to deny itself the opportunity to learn from elsewhere, and to develop governance literacy beyond the boundaries of our own backyard.

Dr Tony Breslin is founder of #R29, Director of Breslin Public Policy Limited and holds a range of governance responsibilities in the education and voluntary sectors. An educationalist, public policy analyst, writer and public speaker, he was previously Chief Executive at the education and participation charity, the Citizenship Foundation and a local authority education adviser. A Better Governance Commission was first called for in his recent Report on school governance 'Who Governs Our Schools? Trends, Tensions and Opportunities' published by the Royal Society for the Arts in September 2017.

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Feature

What price climate change?

Alex Cameron and **David Archer** consider engaging company boards with climate change action planning and the fear of being a first mover.

In 2015 a study by the Economist Intelligence Unit[1] estimated the value at risk to the total global stock of manageable assets, as a result of climate change, as 4.2 trillion to 43 trillion dollars, between now and the end of the century. The timing and nature of the impact of a warming climate may differ across geographies and business sectors but the scale of disruption to markets, customer behaviours, supply chains, and therefore the whole risk environment in which companies operate, is potentially huge.

Climate change scientists have long made the case for urgent action – but this concern is spreading to a wider community of business advisors and investors. A recent report by Schroders[2] creates a dashboard of 12 indicators which track progress towards different temperature change scenarios. Their current aggregate analysis shows the world on a pathway towards an average 4° increase. And such an increase would trigger regional heatwaves that would make many currently densely populated areas uninhabitable and lead to sea level rises of 10m to 60m, swamping coastal conurbations across the world.

So how are boards responding to this challenge? The latest report from international Task Force on Climate-Related Financial Disclosure (TCFD)[3] states that globally 72% of large and mid-cap companies don't even acknowledge the financial risks of climate change in an annual report. We wanted to investigate what is happening in UK boardrooms and what actions directors are taking to prepare their companies to mitigate climate change risks to their future business.

In this article we want to share with you some research carried out by a team from Imperial College Business School[4]. We'll take these findings (and the comments we get in response to this article from *Governance* readers) to a roundtable dinner we are holding with a group of executive and non-exec board members in November. Here we'll get personal perspectives on the realities of getting board engagement with this complex topic in different sectors, and what could be done to increase awareness and effective strategic planning for mitigations. We'll share the results of these discussions with you in a second article later in the year.

Research findings

The Imperial team analysed the latest annual reports from 140 UK listed companies (the biggest ten per sector across 14 sectors) and followed this up with a questionnaire to company secretaries, supported by face-to-face interviews. At one level the findings were as you might expect – very few company boards are reporting on discussions of mitigation strategies to respond to different climate change scenarios – but on another level this lack is extremely worrying. Looking sector by sector the figures are stark. As you might expect, the Energy and Utility sector is the most engaged with 50% of the annual reports studied including climate change as one the top ten risks to the business and describing mitigation strategies. But this sector was very much the exception, in Engineering; Retail, Construction, Transport & Logistics, only one in ten of the reports analysed included climate change as a 'principal risk' – and for the Business Consulting, Media, Healthcare, Technology and Leisure sectors the score was a shocking zero out of ten.

To explore the reasons for this apparent lack of board engagement the research team sent questionnaires to company secretaries and held a number of face-to-face interviews with board members. Six barriers emerged from this phase of research. Some are very predictable: (a difficulty of accessing reliable information on climate change, a lack of understanding of the impacts, more pressing business risks on the board agenda); but others require some more reflection.

A lack of consistent financial evaluation of the timing and scale of climate change impacts was cited as a barrier by several respondents – and this was linked with another barrier, the perceived gap between the long-term effects of a warming climate and a much shorter-term focus to most boardroom discussions. For these two barriers it is clear that regulators and investors have a valuable role to play. For example, the TCFD has developed a standard framework for boards to report on different climate change scenarios. This will enable pension funds and other long-term investors to push companies to report in a consistent manner on strategies for the management of climate change risks. This in turn will mean active shareholders can compare the relative level of preparedness across their portfolio of investments and act on the results.

A final significant barrier raised was the 'fear of being a first mover'. In a situation where; the business risks may be large but difficult to quantify, and the mitigations may be very disruptive, add significant cost to existing operations, and might not work anyway, would you want to go first? Or is it better to sit it out and wait until regulators force you and all your competitors to take similar actions. Now of course some companies have taken the opposite approach and have used a message on climate change action as a part of their market positioning. Carlsberg in the FMCG sector with their 'together

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towards zero' targets and M&S in Retail with their Plan A initiative, are interesting examples[5] to explore. Here being a first mover is being used as a brand differentiator in markets with customer groups who are already engaged with the topic of climate change.

With these six barriers in mind, there are a number of different approaches that could be taken to push climate change planning up the up the board agenda in the UK:

- A sector led approach – where trade groups or other industry bodies could agree common standards and encourage members to report consistently on them. This might be especially useful in low margin sectors where no single company wants to pay the price of going it alone.
- An investor led approach – where groups of investors require the boards whose shares they hold to report on their strategic response to climate change impacts. This may be especially powerful in sectors where investors expect long-term stable performance.
- A customer led approach – where companies can boost their brand loyalty by declaring climate change plans which meet the concerns of their customer base. This might be especially suited to FMCG and Retail sectors.
- A regulatory led approach – where national (and international) regulators require compliance with certain climate change impact disclosures as part of a licence to operate. This might especially apply to Utilities and the Energy sector.

The research shows that the level of engagement for most UK boards with the impact of climate change is currently very low. This cannot continue. The need for boards to engage with the risks that climate change poses to the future of their business is real and pressing. To emphasise this, the 2018 version of the Corporate Governance Code places a renewed focus on long-term sustainability and board responsibility for monitoring 'risks to the future success of the business … the sustainability of the company's business model and how its governance contributes to the delivery of its strategy'.

So what are you seeing in the boards you work with? Are climate change related business risks and their mitigations on the agenda for your next board strategy day? We'd love to learn from your experience – we'll feed your comments into the plans for our roundtable dinner in November and report back to you in a second article on this topic soon afterwards.

Please send your comments and responses to the article via info@socia.co.uk

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1 https://www.eiuperspectives.economist.com/sites/default/files/

2 https://www.schroders.com/hu/sysglobalassets/digital/insights/2017/pdf/sustainable/climate-change-dashboard/climatedashboard-july2017.pdf The%20 cost%20of%20inaction_0.pdf co.uk

3 https://www.fsb-tcfd.org/publications/final-recommendations-report/

4 Research carried out by: William Cross; Diane Mouradian, James Roberts, Sudhiksha Unnikrishnan from the MSc in Climate Change at Imperial College – http://www.socia.co.uk/wp-content/uploads/2018/09/Engaging-Company-Boards-with-Climate-Action-Report.pdf

5 See https://corporate.marksandspencer.com/plan-a and https://carlsberggroup.com/sustainability/our-ambitions/

Feature

Shareholder engagement

Bob McCormick and **Rob Zivnuska** consider how companies can navigate a complex shareholder engagement landscape.

Building successful, long-term relationships with shareholders through engagement is increasingly important as well as increasingly challenging for UK companies, particularly those with large US-based or other international shareholders who follow varied approaches to meeting with companies. Engagement today is a year-round activity that includes ever-larger index investors and covers a broader range of topics and meeting styles. To ensure such engagements are productive in developing strong relationships with a changing investor base, companies must develop a bespoke approach that takes into account the history, priorities and practices that have shaped the rise of global investor stewardship teams.

Differing styles of engagement

One of the most significant differentiating factors between engagement styles in the UK and the US has been the role of directors. Consistent with the Corporate Governance Code, in the UK board Chairs generally lead engagement efforts, often without a representative from the executive team. However, in the US engagements are traditionally led by the executive team, nearly always including the corporate secretary, head of investor relations or equivalent business leader. While director participation in engagements in the US is increasing, directors typically participate in US investor meetings when there are significant concerns on board-centric topics such as CEO performance, executive remuneration, or board composition. Even when discussing these types of topics, some investors prefer not to engage with directors, believing that discussions with executives are more informative.

UK issuers familiar with the long tradition of a detailed corporate governance code in their home country will encounter a more varied approach in the less prescriptive principles in the US. The more uniform approach among companies and investors in the UK is driven by the Stewardship Code[1] as well as the long-standing and recently-updated Corporate Governance Code which now imposes substantial reporting obligations on companies to consult with shareholders when more than 20% of votes are cast against a resolution supported by the board. In the US, such codes have only emerged in the last few years – the Commonsense Principles[2] and those established by the Investor Stewardship Group[3] – and neither is followed with the same allegiance as those in the UK. Among other differences, the UK Code embraces a ‘comply or explain’ approach whereas the US principles are merely advisory and geared toward creating minimum standards that complement America’s multi-faceted federal, state and exchange-based regulatory model.

Another substantial difference between the US and the UK is collective versus individual engagement. In the UK, investors frequently conduct group engagements with companies, allowing issuers to hear the views of several investors at the same time, often with a high level of consensus consistent with the Corporate Governance Code. This process, which can facilitate decisions in the boardroom, is not part of engagement culture in the US due in part to US regulatory standards that make legal or compliance teams uncomfortable with activities that might create an appearance that investors are acting as a ‘group’ (thereby triggering new filing requirements), US investors are accustomed to engaging one-on-one with issuers and differ even about fundamental governance issues such as the appointment of an independent board Chair.

Rise of investment stewardship in the US

The implications of these differences have become increasingly relevant over the past decade as shareholder registers have been transformed by the dramatic shift of assets from active to passive funds. Today, many companies around the globe, including those in the UK, have as their largest investors the US-based asset managers Blackrock, Vanguard and State Street Global Advisors. The broad shakeout of the asset management industry has had widespread impacts ranging from the consolidation of active managers to increasing scrutiny of, and competition among, passive fund managers regarding their attentiveness to investment stewardship activities.

Indeed, in response to both requirements from initiatives such as the PRI[4] as well as client demands, US-based asset managers are now much more proactive about engaging issuers around the globe on issues that they view as risks to or opportunities for long-term value creation. To meet that need, passive managers (and some active managers as well) are building larger, more specialised global governance and voting teams. BlackRock, which has had governance analysts located in the UK for some time, for example, plans[5] to double the size of its global investor stewardship team within the next few years. Vanguard has also grown its stewardship team and relocated[6] to the UK one of its seasoned governance analysts to establish a new, regionally-focused function responsible for direct engagement with boards and executives and proxy voting at European portfolio companies on behalf of Vanguard’s global funds.

Investment style can determine engagement style

A key to successfully navigating engagement with these growing investment stewardship teams is to understand how

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asset managers' investment styles, as well as their personnel, dictate their approach. Engagements with the governance teams at large index funds require a different approach than meetings with an investment analyst steeped in the story of the company and its industry. Company representatives should be prepared to provide index funds' governance analysts some background on the company, its competitive environment, performance history, capital allocation decisions, approach to sustainable business practices and overall strategy.

Among active managers, the governance discussions may include portfolio managers (PMs) and equity analysts who will want to discuss business strategy and performance, as well as specialist investment stewardship teams. Investment stewardship teams at active firms will routinely consult with PMs and analysts around financially significant voting decisions like mergers and acquisitions. While some firms prefer a PM-led voting model, others have investment stewardship teams lead the voting decisions with varying levels of input from the investment team. Regardless of their investment approach, companies should understand the engagement approach taken by each investor and the specific individuals with whom a company will be meeting to facilitate a more efficient and fruitful meeting.

Adding to the complexity of potential variation within a company's investor base is the additional question of where an investor's engagement team is located. Several large US global investors have governance analysts based in London who have deep local market expertise and are available to engage in-person with UK companies, promoting the development of closer relationships between the companies and these investors. However, not all US investment firms have UK offices and, even some that do have investment personnel in the UK, locate their global stewardship teams in the US; therefore engagements with these investors' governance analysts generally take place by telephone. To further underscore the need for a thoughtful approach to engagement, some investors maintain distinct UK (or global) and US entities, meaning that companies may have to engage with different groups of governance analysts from what may initially appear to be the same investment firm.

Governance teams expand the scope of their interests

Greater resources dedicated to investment stewardship means that investors have more capacity to engage in increasingly detailed discussions on a broad range of subjects beyond standard board, governance and remuneration themes. Issuers can expect that a typical governance engagement discussion may also touch on a range of environmental and social (E&S) issues such as human capital management, supply chain integrity, climate risk disclosure and pay equity. Investors may also inquire about the board's role in establishing, maintaining and overseeing corporate culture.

As the benefits of shareholder engagement have become more broadly appreciated by both US issuers and investors, many investors now receive many more engagement requests than they have capacity for. As a result, securing a meeting has become increasingly difficult. Some US-based investors will only allot one call or meeting each year, raising the stakes around the decision to engage either on a preliminary basis to solicit feedback or closer to the AGM to seek support for actions they have taken. Companies that otherwise enjoy strong support from shareholders but that still want to engage may need to provide a compelling reason when requesting a meeting since some investors will decline meetings in the absence of company-specific concerns. Understanding the expectations and needs of each firm with whom issuers seek to engage is more important than ever in securing an engagement opportunity.

Role of proxy advisors and E&S research firms

UK companies should also take into account the role and impact of proxy advisors and environmental and social (E&S) research and ratings firms in their broader engagement plan. Engaging with proxy advisors to ensure open lines of communication regarding investor feedback is considered a best practice. In addition, understanding how investors use proxy advisor data and whether and to what extent investors depend on the advisors for voting recommendations or have their own proxy voting guidelines is a key to having successful engagements and securing investor support.

Issuers should also be aware of how their sustainability policies and practices are being represented in reports generated by E&S research and ratings providers such as MSCI and Sustainalytics. While investors and issuers alike review the reports created by these providers, the data collection processes at such firms are challenged by the lack of standardised disclosure regimes. Companies should engage with investors and ratings firms to ensure that both parties accurately understand the company's E&S practices and risk mitigation structures and initiatives.

Meet investor expectations by knowing your audience

Understanding the priorities and engagement practices of US-based investors, and devising a bespoke approach to approaching and meeting with top shareholders, is a key consideration in building and maintaining successful relationships in a dynamic market. While many global investors may acknowledge and adhere to the traditions of a company's home country in engagement and voting decisions, some employ a more universal approach across borders. As US-based investors build out their engagement teams in Europe and beyond, and European-based investors grow their presence in the US, a continued cross-pollination

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of engagement themes and styles is a likely result. Being able to adroitly navigate the shifting landscape will be a defining challenge for companies and boards in the years ahead.

Bob McCormick and Rob Zivnuska are Partners at Camberview Partners http://www.camberview.com/ the leading provider of investor-led advice to public companies on engagement and shareholder relations, activism and contested situations, sustainability and complex corporate governance matters.

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