CLIFFORD CHANCE

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# Your 2015 AGM and beyond

The 2014 AGM season was challenging for many listed companies as they grappled with significant regulatory change: the requirement to prepare a new style remuneration report, the replacement of the business review with a standalone strategic report, the requirement to report on the company's greenhouse gas emissions, and enhanced auditor and audit committee reporting requirements.

Companies will be relieved that the amount of regulatory change that will impact on their 2015 AGMs is fairly limited, with the greatest impact on those companies with a controlling shareholder.

All companies will however need to consider how market practice in respect of remuneration reporting is emerging, following the introduction of the new reporting regime last year, and consider how to reflect shareholder concerns in this year's remuneration report. Our centre spread on pages 4 – 5 looks at some of the trends emerging from the new remuneration reporting regime and considers some emerging issues that companies may wish to address in their 2015 remuneration reports.

Looking beyond the next AGM, further changes are on the horizon. These include reporting against the new Corporate Governance Code (which applies to accounting periods starting on or after 1 October 2014) which has a heightened focus on risk management and internal control. For companies in the extractive industries sector, they will also need to start disclosing payments to governments on a world-wide basis. These and other relevant developments are discussed on pages 6 – 8.

## Key changes

- Companies with a controlling shareholder will need to ensure that the election/re-election of each independent director is approved at their AGM by a vote of both shareholders and independent shareholders of the company
- New controlling shareholder disclosures required in the annual report
- New requirement to include a cross reference table in the annual report
- New version of Corporate Governance Code with a heightened focus on risk management and internal control: applies to FY starting from 1 October 2014
- Companies in the extractive industries sector to report annually on payments to governments on world-wide basis for FY starting on or after 1 January 2015

## What's new for your 2015 AGM?

### Companies with controlling shareholders – changes to Notice of AGM required

***Election of INEDS:*** Following the introduction of changes to the Listing Rules in May 2014, any premium listed company with a controlling shareholder[1] will need to ensure that the election and re-election of each independent director at its AGM is approved by both (1) the shareholders of the company as a whole and (2) the independent shareholders (i.e. excluding the controlling shareholder).[2]

The FCA has confirmed that, if the votes of the independent shareholders can be identified by the company, this requirement can be met by proposing a single resolution and holding a single vote. We are seeing a mix of approaches being adopted. For example, British Sky Broadcasting proposed a single resolution for the election of each independent

1 Broadly, any person who exercises or controls (either on their own or together with any person with whom they are acting in concert), 30% or more of the votes of the company.

2 Listing Rule 9.2.2E.

director but explained in the notes to the resolution that the resolution needed to be passed by both the shareholders and independent shareholders of the company. Rank Group took a different approach and proposed two separate (but inter-conditional) resolutions for the election of each independent director, one to be voted on by the shareholders as whole and one by the independent shareholders alone.

Whatever approach a company chooses to adopt, the notes to the resolution need to make clear the implications of the resolution not being passed in the manner required; that is, that the company cannot propose a further resolution to elect or re-elect the director until 90 days after the date of the AGM and that any such resolution must be passed within 30 days of the end of that 90 day period, but may be passed by a single vote of the shareholders (i.e. including the controlling shareholder).

***No amendments to articles required:*** The Listing Rules require that a company with a controlling shareholder must have in place at all times a constitution that allows the election and re-election of independent directors in the manner described above.[3] It is not necessary for a company to amend its articles to expressly permit election and re-election in this manner. If, however, a company's articles contain a prohibition on election in this way, the prohibition will need to be removed. We would not expect this to be the case for the majority of companies, but companies should check their articles.

***Controlling shareholder disclosures in annual report[4]:*** The annual report must contain a statement by the board confirming that, where required to do so


by the Listing Rules, the company has entered into a controlling shareholder agreement. Where no such agreement has been entered into, the annual report will need to contain a statement that the FCA has been notified of this non-compliance, together with a brief description of the reasons for the company's failure to enter into such an agreement.

Where an agreement has been entered into, the board will need to confirm that the independence provisions have been complied with or, if this is not the case, a description of the reasons for non-compliance and a statement that the FCA has been duly notified of it.

If any of the company's independent directors decline to support any of the above statements, their position must be stated in the annual report.

For further information on the new controlling shareholder regime in the Listing Rules, see our briefing *Listing Rule changes relating to controlling shareholders to take effect on 16 May 2014* which is available here:

www.cliffordchance.com/briefings/2014/05/listing_rule_changesrelatingtocontrollin.html

## New requirement to include cross reference table in the annual report

Companies will need to ensure that their annual report includes all the information required by LR 9.8.4R (information to be included in annual report and accounts) in a single identifiable section, unless the report includes a cross reference table indicating where that information is set out.[5] This requirement applies to a premium listed company with a financial year ending after 31 August 2014.

3 Listing Rule 9.2.2AR(2)(b).

4 Listing Rule 9.8.4R(14).

5 Listing Rule 9.8.4CR.

## Key trends from the 2014 reporting and AGM season

**38** — the number of FTSE 100 boards having at least 25% **female directors** as at 14 October 2014 – up from 31 in October 2013. All FTSE 100 companies now have at least 1 female director

**27** — the number of FTSE 350 companies tendering their **external audit**. Of these, 19 resulted in a change of auditor. All 27 tenders resulted in the appointment of one of the 'Big 4'

**91%** — the percentage of FTSE 100 companies that included a statement on **human rights in their annual report**. Of the remaining 9%, 6% included no statement and 3% included a statement that the report did not include any human rights disclosures

**100%** — the percentage of FTSE 350 companies proposing **annual re-election of all directors**

**60%** — the percentage of FTSE 100 companies that sought **authority to allot an additional one-third of their share capital**, down from 65% in 2013 and 69% in 2012

**1** — the number of companies that failed to obtain sufficient shareholder support for the remuneration policy to be passed; 2 companies failed to attain shareholder support for the remuneration report resolution to be passed

**21** — the number of FTSE 100 companies receiving a vote of between 10% and 49.9% against their directors' remuneration report; the number for FTSE 250 companies was 31

*Statistics taken from Practical Law's "Annual Reporting and AGMs 2014: what's market practice?" published on 26 November 2014. Statistics based on PL's review of the notices of AGM and annual reports of over 300 FTSE 350 premium equity commercial companies (and for voting and results statistics, a review of 285 FTSE 350 companies that had held their AGM and published results prior to 31 October 2014).*

# Directors' remuneration reporting: emerging market practice?

The 2014 AGM season was the first in which UK quoted companies had to prepare a new style remuneration report, split into two parts: (i) the chairman's annual statement and directors' implementation report; and (ii) the directors' remuneration policy. It was also the first time that companies had to put their remuneration policy to a binding shareholder vote.

Consequently, 2014 was a busy year for companies, with the vast majority making changes to their remuneration policies. Whilst a few companies saw a shareholder vote of more than 20% against their remuneration policy[6], only one company, Kentz Corporation, saw its policy voted down, with 58% of shareholders voting against the policy. Kentz and Burberry also had their implementation reports rejected by shareholders. Although this vote is advisory only, it triggers a requirement to put the remuneration policy back to a shareholder vote at the next AGM.

Given that the majority of companies anticipate their remuneration policy will not be resubmitted to shareholders for three years, 2015 should be quieter, with fewer companies putting their remuneration policy to a shareholder vote. Three of the four FTSE100 companies with September year ends are submitting revised remuneration policies to shareholders at their 2015 AGM. We do not expect this to be the broader trend but rather a reflection of the fact that these companies were the first to put in place remuneration policies under the new regulations.

However, as executive pay remains a major focus for shareholders and the media, the annual implementation report will doubtless continue to be scrutinised.

Shareholder bodies continue to publish guidance to assist companies in preparing their remuneration reports, with the GC100 and Investor Group publishing a statement (the "**GC100 statement**") on 17 December 2014 updating its existing Directors' Remuneration Reporting Guidance.

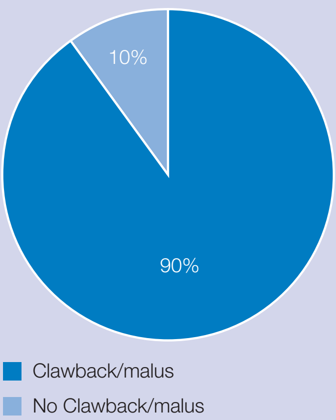
We set out below the trends emerging from remuneration reports published in 2014 which may impact on companies' 2015 implementation reports.

***Performance conditions:*** Performance conditions that apply to annual bonus and incentive plan awards are important in linking pay with performance. Shareholders are focusing on:

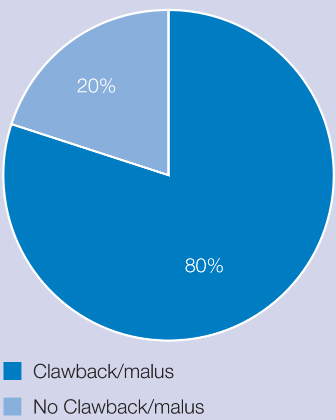
1) *Retrospective disclosure of annual bonus targets:* Many companies chose not to disclose targets as they are commercially sensitive. The IMA[7] has stated that disclosure has "deteriorated" under the new rules and calls on companies to disclose (retrospectively) actual performance and the performance range for annual bonus targets. The GC100 statement recognises that prospective disclosure of targets is likely to cause difficulties, but echoes the IMA in expecting retrospective disclosure once targets are no longer commercially sensitive. In the last reporting season, nearly a quarter of FTSE 100 companies indicated they will disclose annual bonus targets retrospectively.
2) *Amounts payable for threshold performance:* The IMA has stated that absolute amounts payable for achieving only threshold performance are a concern and companies are encouraged to consider the absolute amount received as well as the proportion of the award that vests.
3) *Disclosure of maximum potential bonus:* The GC100 statement states investors expect the maximum level of remuneration, including the maximum possible level of bonus payable to executive directors, to be disclosed on an individual basis.

***Malus and clawback:*** Including clawback and/or malus in bonus and long term incentive plans has become the norm. Further impetus has been added by recent changes to the Corporate Governance Code requiring companies to either include clawback and malus provisions in performance-related plans for executive directors or explain why they are not included. This change applies to accounting periods beginning on or after 1 October 2014, giving companies time to consider whether to make relevant changes to bonus and incentive plans. The GC100 statement recognises that remuneration policies drawn up under the previous Corporate

**FTSE 100 companies with clawback/malus 2014**




**FTSE 250 companies with clawback/malus 2014**




6 For example, Capital & Countries Properties (24.65%), Easyjet (45%), FirstGroup (30.95%), Mitie Group (28.13%), Ophir Enegy (32.89%), SVG Capital (35.60%). Dissent for these purposes includes votes against plus abstentions. Figures taken from NAPF's 2014 AGM Season Report.

7 IMA is the Investment Management Association which merged with the ABI in June 2014 and was renamed The Investment Association in January 2015.

Governance Code, which are expected to last three years, may not include such provisions. As a result, the GC100 take the view that companies can choose to defer this change to the next scheduled policy update and so "explain" (rather than "comply") with this requirement of the Corporate Governance Code until then. Alternatively, companies can put a revised policy to shareholders or find another solution whereby a change can be made without awards and payments being inconsistent with an approved policy. In our experience companies have been able to make this change without the need to obtain shareholder approval for a revised policy.

Experience to date is that individual companies have taken different approaches to the scope of their clawback/malus provisions. It makes sense for companies to spend time deciding what is right for them in light of their sector, geographies, employees and attitude to risk and incentivisation.

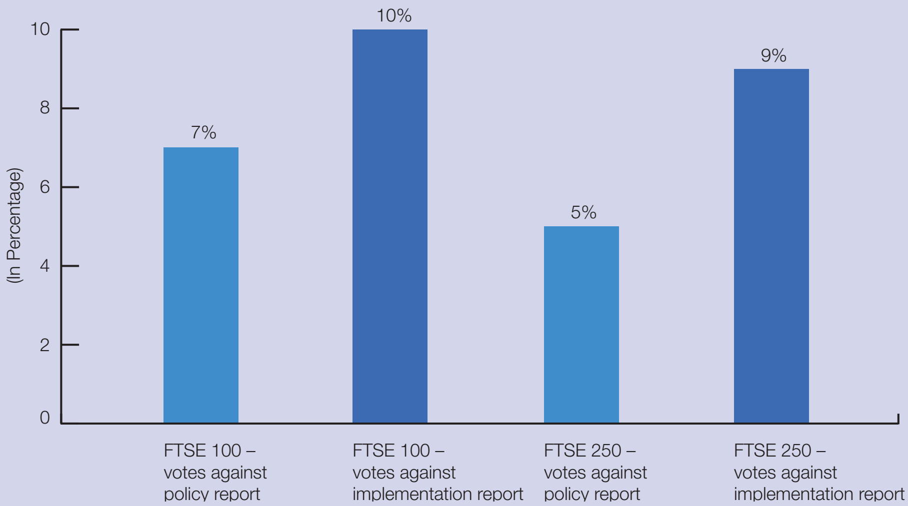
***Including LTIP holding periods:*** Institutional investors increasingly require companies to impose a holding (or retention) period following the end of a performance period. About half of FTSE 100 companies operate incentive plans over more than three years with the most common holding period being two years (giving a total "plan period" of five years). Again, this trend is supported by the Corporate Governance Code, which recommends that remuneration committees consider imposing holding periods following the vesting/exercise of an award, including for a period after leaving the company. This was reiterated by the IMA which encourages companies to consider long performance periods and/or holding periods.

Companies putting new incentive plans to shareholders in 2015 are likely to want to include a holding period. We are also seeing companies amend existing plans or impose a holding period as a term of grant for awards to executive directors. There are a few tricky issues (e.g. permitting sales for tax and dealing with awards that are options) where market practice has not yet settled and companies will need to decide on the best approach.

***Engaging with investors:*** Although a large number of companies made changes to their remuneration policy in 2014, relatively few received shareholder votes against either their remuneration policy or implementation report. The chart below shows the percentage of companies in the FTSE 100 and FTSE 250 that received a significant (i.e. at least 20%) negative vote.

Shareholder bodies are encouraging companies to consult with their shareholders as early as possible if they are making changes to remuneration in 2015. The IMA asks companies to make clear whether they are consulting shareholders or simply notifying them of a change. Companies are also encouraged to notify shareholders when a consultation process has ended and inform them of decisions made.

***Percentage of companies in FTSE 100 and FTSE 250 receiving a vote of more than 20% against the policy or implementation report***




Although companies now have an approved policy, the 2015 implementation report vote is important for two reasons. First, if shareholders vote against the 2015 implementation report companies must put their remuneration policy to the vote again at the next AGM. Second, the Corporate Governance Code provides that if a significant proportion of shareholders vote against any resolution (including a remuneration resolution) the company must explain in the next annual remuneration report what actions it will take to understand the reasons for that vote. The GC100 suggests that 20% would contribute a significant proportion of shareholder votes.

***Drafting notes – whether to include the remuneration policy?:*** Remuneration reports have grown over the past year, with reports averaging 20 pages in 2014 compared to an average of 12 pages in 2013. Companies may seek to reduce the size of these reports in 2015 by omitting the remuneration policy (save where it is being put to a shareholder vote). Where it is omitted companies must indicate where shareholders can access the policy (e.g. on the company's website). The IMA has said it would be "helpful" for companies to include the remuneration policy table in the remuneration report as a minimum while the GC100 statement says "at least the policy table should be included" with a full copy of the policy available on the company's website and signposted in the directors' remuneration report.

Emerging practice on this is mixed, with some companies indicating they intend to keep the full policy statement in the report (often to avoid redrafting!) and others considering including only the policy table. While it is very early days, we have not yet come across companies removing the policy report entirely and referring only to their website.

# Looking ahead

There are a number of developments that will impact on a listed company's 2015 annual report. With an increased focus on risk management and internal controls, companies will want to revisit their practices in this area.

For companies in the extractive industries sector, they will be required to report on payments to governments on a world-wide basis. This may require new reporting systems to capture such payments. This may be particularly challenging given the breadth of payments caught by the new legislation. These changes are discussed in more detail below.

## A new Corporate Governance Code

An updated version of the Code was published in September 2014 and applies to financial years starting on or after 1 October 2014. As such, for a company with a calendar year end, it will need to report against the new Code when it comes to prepare its annual report for the financial year ending 31 December 2015.

***A heightened focus on risk management and internal control:*** Provision C.2.1 (annual review of risk management) of the Code has been rewritten to sharpen the board's focus on risk management and internal control. In particular, the Code now recommends that:

- the directors confirm in the annual report that they have conducted a robust assessment of the company's principal risks and explain how such risks are being managed and mitigated (new provision C.2.1);
- taking account of the company's current position and principal risks, the directors should explain in the annual report that they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment (new provision C.2.2); and
- the board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report to shareholders on the same (new provision C.2.3).

The introduction of a "long term viability statement" in provision C.2.2 has raised some concerns. New FRC guidance published in September 2014[8] states that, except in rare circumstances, the period covered by the disclosure pursuant to C.2.2 should be significantly longer than 12 months from the approval of the financial statements. Given the difficulties of predicting uncertain events, there are concerns that this disclosure may need to be accompanied by heavily caveated statements from directors and that, therefore, this will provide only limited value to investors. However, directors may equally be concerned that a heavily caveated statement may convey an unduly negative message to the market which could shape investor sentiment. Careful drafting will be required when companies come to prepare these statements next year.

***Change to going concern statement:*** The going concern statement (provision C.1.3) has also been rewritten to have a more forward-looking focus. The Code now recommends that directors state in their annual and half yearly financial statements whether they consider it appropriate to adopt the going concern basis of accounting and to identify any material uncertainties to the company's ability to continue to do so over a period of at least 12 months from the date of approval of such statements. Previously, there was only a requirement to state that the business is a going concern and to include supporting assumptions and qualifications.

***Must general meetings be convened on 14 "working days" notice?:*** When the final text of the September 2014 version of the Code was published, it was


**View from the top: A board-level perspective on current business risks**

This report by Clifford Chance is based on a global survey carried out by The Economist Intelligence Unit to assess boardroom attitudes to risk. In the aftermath of the global financial crisis, the survey of board members from across the world's largest global corporates explored which areas of risk feature at the top of board agendas, the extent to which board-level investment in risk management is paying off, and the depth of change required to ensure more robust risk management.

www.cliffordchance.com/GlobalRiskReport

8 FRC Guidance on risk management, internal control and related financial and business reporting (September 2014). This Guidance replaces the FRC's Internal Control Guidance (October 2005) and Going Concern and Liquidity Risk: Guidance for Directors of UK Companies (October 2009).

noted that provision E.2.4 had been amended (without prior consultation) to recommend that notice of general meeting be sent to shareholders at least 14 "working days" in advance of the meeting (as opposed to the standard 14 clear days' notice). The FRC have since indicated informally that this amendment was made inadvertently. Pending a formal confirmatory statement from the FRC, companies that hold a meeting without complying with this provision should simply explain any non-compliance.

## Companies in extractive industries required to disclose payments to governments

New European rules requiring the disclosure of payments to governments by companies in extractive industries and loggers of primary forests were adopted in June 2013. On 1 December 2014 new UK regulations came into force implementing these EU rules. The regulations require affected companies to prepare their first reports for financial years commencing on or after 1 January 2015 and to file such reports at Companies House within 11 months of the end of their financial year.

On 22 December 2014, the FCA made changes to its Disclosure and Transparency Rules (to reflect changes to the EU Transparency Directive) which mean that, for listed companies, the timeframe for filing the payments to governments report is reduced to six months, meaning that a listed company with a 31 December year end will need to file its first report by 30 June 2016.

Companies should ensure that relevant internal reporting is put in place to ensure that all such payments (including payments to both to governments and government bodies at regional and local levies and their agencies) are captured. In doing so, companies should bear in mind that reporting must be on a country-by-country, project-by-project basis and be broken down by type of payment (e.g. tax, royalty, licence fee, payment for infrastructure improvements, discovery bonus, etc). Disclosure must reflect the substance, rather than the form, of each payment, activity or project concerned.

Draft industry guidance was published in November to assist companies in determining how best to comply with these new reporting requirements.

For further details see:

www.cliffordchance.com/briefings/2014/09/bis_confirms_earlyadoptionofregulation.html

## No more interim management statements

Changes to the Disclosure and Transparency Rules which took effect on 7 November 2014 mean that it will no longer be mandatory for listed companies to publish interim management statements. Companies may continue to publish such statements if they wish to do so but will not be constrained by the content requirements previously set out in DTR 4.3.

## CMA legislates on audit rotation

The Competition and Markets Authority (**CMA**) has published legislation that will require FTSE 350 companies to put their statutory audit services engagement out to tender at least every 10 years (consistent with the best practice recommendation in the Corporate Governance Code). This legislation, which is expected to come into force in January 2015, applies to financial years beginning on or after 1 January 2015. It will require:

- FTSE 350 companies to put their statutory audit services engagement out to tender at least every 10 years. As such, an auditor may not conduct more than 10 consecutive statutory audits of a FTSE 350 without a competitive tender taking place;
- the terms of the statutory audit services agreement, including the fee and scope, to be negotiated and agreed between the audit committee and the auditor;
- where a competitive tender process has not been completed for auditor appointment in relation to five consecutive years, the audit committee must state in the audit committee report the financial year in which the company intends to conduct a competitive tender process and why this period is in the best interests of shareholders. This information must be included in the report for each subsequent year until a competitive tender process is completed; and
- the inclusion of a statement of compliance with the provisions of the legislation in a company's audit committee report for each financial year.

***When does a company first need to tender under the new rules?***

**Auditor having held office for less than 11 years as at 16 June 2014**
- Obligation to tender in respect of appointments made on or after 17 June 2016

**Auditor having held office for more than 11 years but less than 20 years as at 16 June 2014**
- Obligation to tender in respect of appointment made on or after 17 June 2023

**Auditor having held office for more than 20 years as at 16 June 2014**
- Obligation to tender in respect of appointments made on or after 17 June 2020

The transitional provisions are somewhat counter-intuitive as the result is to require companies where the auditor has been in place for the shortest period of time to tender first. However, the CMA's approach is in line with the provisions of new EU legislation which was introduced in 2014 and which will require mandatory auditor rotation every 10 years, which may be extended by a further 10 year period where a tendering process is conducted. This legislation must be implemented into national law by 16 June 2016. In December 2014, BIS published a discussion paper, *Auditor Regulation: Discussion document on the implications of the EU and wider reforms*, ahead of a formal consultation to be published in 2015. The paper seeks views on a range of reforms, including audit tender, to strengthen the audit regime. Responses are required by 19 February 2015. The BIS discussion paper is available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/386811/bis-14-1285-auditor-regulation-discussion-document-on-implications-of-eu-and-wider-reforms.pdf

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