

YOUR 2018 AGM UPDATE AND BEYOND

No major changes are required to companies' AGM notices for 2018.

However, there are a number of narrative reporting changes, including the requirement to include a non-financial information statement in this year's strategic report.

Further narrative reporting changes are around the corner as a result of the Government's response to its November 2016 Green Paper on corporate governance reform. Notably, the FRC has recently published for consultation an updated form of the UK Corporate Governance Code and the Government will publish legislation in the new year requiring large companies (both public and private) to report on how directors comply with their statutory duties and requiring large listed companies to reveal the pay ratio between their CEO and their average UK worker.

In this Update, we examine the developments and changes affecting this season's AGMs and annual reports and look ahead to other changes on the horizon.

WHAT'S NEW FOR 2018?

Non-financial information statement: A UK quoted company¹ is currently required to include in its strategic report, to the extent necessary for an understanding of its business, information about the main trends and factors likely to affect the development of its business and information about environmental matters, employees, and social, community and human rights issues.²

As foreshadowed in our [2017 AGM Update](#), for financial years starting on or after 1 January 2017, a traded company³, banking company and insurance

Key Issues

- New requirements to include:
 - a non-financial information statement in the strategic report; and
 - information on the company's diversity policy in the corporate governance statement.
- Companies should assess whether it is appropriate to include any disclosures relating to the potential impact of Brexit on their businesses in the strategic report.
- Continued focus on board diversity as Parker Review recommends that each FTSE 100 Board should have at least one director from an ethnic minority background by 2021 and that each FTSE 250 Board achieves the same by 2024.
- FRC consultation on changes to UK Corporate Governance Code to require boards to ensure that the views of the workforce are heard, to report on how they have engaged with the workforce and other stakeholders and how the interests of the workforce and other stakeholders and directors' statutory duties influence board decision making.

¹ A quoted company is a company with equity share capital that is (i) included in the FCA's Official List, (ii) officially listed in the EEA or (iii) admitted to dealing on the NYSE or Nasdaq.

² Section 414C CA 2006

³ A traded company means a company with transferable securities admitted to trading on a regulated market.

company with more than 500 employees must also include a non-financial information statement⁴ in its strategic report.

The key content requirements for the non-financial information statement are set out in the box opposite. The Companies Act 2006 acknowledges the overlap between the existing strategic reporting requirements and the new non-financial information statement requirements. Accordingly, it sets out where compliance with the requirements for the non-financial information statement will be treated as compliance with certain of the existing reporting obligations for strategic reports. For most UK quoted companies, the requirement to include a non-financial information statement will supplement their existing strategic reporting requirements and they will only need to identify the additional information to be included in this year's report.

The FRC has published a [factsheet](#) providing an overview of the new non-financial reporting requirement. In addition, companies should also have regard to the [letter](#) sent by the FRC to audit committee chairs and finance directors in October 2017, summarising the key developments for 2017/2018 annual reports, which contains an overview of this new requirement, as well as information on new accounting standards and financial statement disclosures.

In August 2017, the FRC published for consultation proposed amendments to its 2014 [Guidance on the Strategic Report](#) to reflect the requirement for a non-financial information statement and to enhance the linkage between the strategic report and the directors' statutory duty in section 172 of the Companies Act 2006 to promote the success of the company for the benefit of its members. In December 2017, the FRC announced that the amendments to its Guidance would be delayed, pending publication by the Government of new legislation relating to section 172 reporting. On 4 December 2017, the FRC published [Q&A](#) on non-financial reporting, intended to serve as a guide in the interim.

Diversity Reporting: The Disclosure and Transparency Rules contain a new requirement this year for each company to include in its corporate governance statement a description of the diversity policy applied to management with regard to issues such as age, gender, educational or professional backgrounds. The company must also include a description of the policy's objectives, details of how the policy has been implemented and its results in the reporting period. If no diversity policy is applied then the corporate governance statement must include an explanation of why this is the case. (See [DTR 7.2.8AR](#), which applies to financial years beginning on or after 1 January 2017.) The Corporate Governance Code already requires companies to have due regard for the benefits of diversity on the board, including gender (Principle B.2)

In developing its diversity policy and ensuring it remains in line with best practice recommendations, companies will want to consider the recommendations of both the Final Report of the [Parker Review](#) on ethnic diversity on boards published in October 2017 (see the box on page 3) and the [supplemental report](#) published in November 2017 by the Hampton-Alexander Review on improving the gender balance in the leadership of FTSE companies. The Hampton-Alexander Review finds FTSE 100 companies are on track to meet the target of having one third of board positions held by women by 2020 (women now occupy 28% of board positions in FTSE 100

Contents of Non-Financial Information Statement

The non-financial information statement must include:

- information, to the extent necessary for an understanding of the company's development, performance and position and the impact of its activity, relating to, as a minimum (i) environmental matters (including the impact of the business on the environment), (ii) the company's employees, (iii) respect for human rights, and (iv) anti-corruption and anti-bribery matters;
- a brief description of the company's business model;
- a description of a company's policies on the matters referred to in (i) – (iv) above;
- a description of the outcome of those policies and the due diligence processes implemented pursuant to those policies;
- a description of the principal risks related to the matters set out in (i) – (iv) above and how the company manages them; and
- a description of the non-financial KPIs relevant to the company's business.

Where a company does not have policies in relation to any of the matters referred to in (i) – (iv) above, the statement must provide a clear and reasoned explanation.

⁴ Sections 414CA – 414CB CA 2006

companies), but has called on FTSE 350 companies to quicken the pace of change and has extended the 33% target of women in senior leadership positions to all FTSE 350 companies (previously this voluntary target only applied to FTSE 100 companies).

Impact of Brexit: With uncertainty continuing to surround the terms of any Brexit deal and any transitional period, companies will need to consider the nature and extent of such risks and uncertainties and their impact on the future performance and position of the business. In its October 2017 [annual review of corporate reporting](#) for 2016/2017, the FRC made clear its expectation that companies should continue to focus on their Brexit-related disclosures. Practical Law⁵ reported that for the 2016/2017 annual reporting season, 63% of those FTSE 350 companies reviewed, made reference to Brexit in one or more of their principal risks. This is likely to be a continuing theme in the 2017/2018 reporting season.

Audit reporting: This year, many companies will be reporting for the first time against the April 2016 version of the UK Corporate Governance Code which applies to financial years starting on or after 17 June 2016. Companies will need to remember to include a statement in the audit committee report providing advance notice of any audit tendering plans (provision C.3.8). The April 2016 version of the Code also contains a recommendation that the audit committee as a whole should have competence relevant to the sector in which the company operates (provision C.3.1), which is also reflected in the FRC's updated [Guidance on Audit Committees](#) (April 2016). Each company will need to report on whether its audit committee's composition for the 2017 financial year is compliant with the updated Code requirements.

Modern Slavery Statements: In our [2017 AGM Update](#) we highlighted section 54 of the Modern Slavery Act 2015 which requires commercial organisations which (a) supply goods and services and (b) have a turnover of £36 million or more, to produce a slavery and human trafficking statement for each financial year in which the criteria are met. The statement must set out the steps taken to address slavery and human trafficking in the organisation's own business and in its supply chains, or state that no such steps have been taken. Companies with a 31 December year end had until June 2017 to publish their first statement in relation to their 2016 financial year. Although the act only requires the statement to be published on a company's website, there is a clear trend emerging that companies are referring to these statements in their annual reports. Given the need to report on matters relating to human rights in the strategic report, this is often a natural place to include a reference to the modern slavery statement.

Virtual AGMs: Last AGM season, there was much discussion around the first wholly virtual AGM held by Jimmy Choo in June 2016 and 13 companies changed their articles during the 2017 AGM season to permit virtual AGMs (i.e. meetings which are held exclusively through the use of online technology without a corresponding physical meeting). Since then, a number of practitioners have cast doubt on whether a notice of AGM that fails to state a physical place of meeting properly complies with the Companies Act 2006 requirements. If it does not, the meeting would not be properly convened and the business of the meeting would be invalid. In the absence of an amendment to the Companies Act 2006 to permit wholly virtual meetings (and

Findings of the Parker Review

- Increase the ethnic diversity of UK Boards by proposing that each FTSE 100 Board should have at least one director from an ethnic minority background by 2021 and that each FTSE 250 Board achieves the same by 2024.
- That companies focus on developing mechanisms to identify, develop and promote people of colour to ensure that there is a pipeline of board-capable candidates and that managerial and executive ranks appropriately reflect the importance of diversity to the organisation (including having directors mentor and sponsor people of colour to ensure their readiness to assume senior executive positions internally or non-executive roles externally).
- Enhance transparency and disclosure to record and track progress against these objectives.

⁵ Practical Law Annual reporting and AGMs 2017: What's Market Practice?

bearing in mind the views of both the Institutional Shareholder Service and the Investment Association (see box opposite)), we would not advise companies to hold a virtual only meeting, even where the provisions of their articles would permit.

It remains the case that, provided a company's articles permit, a hybrid meeting, with both a physical location and a virtual platform which allows shareholders to participate remotely, is permissible. However, prior to any such meeting, the articles of the company should be carefully reviewed in order that the chair is fully briefed on what action he or she should take in the event that the technology fails, resulting in any shareholders being unable to participate.

EXECUTIVE REMUNERATION

Executive remuneration was in the spotlight again in 2017, not least because many listed companies put their directors' remuneration policies to shareholder votes during the 2017 AGM season. It was also a year that saw a raft of governance changes announced, many of which will affect directors' remuneration from 2018.

We expect 2018 will be quieter than 2017 in some respects as far fewer companies will put their remuneration policy to shareholder votes. However, as executive pay is still a focus for shareholders and remains in the public spotlight, directors' remuneration reports ("**DRR**") will doubtless continue to be scrutinised and companies should be prepared for that. There are a number of key points for companies to consider for 2018.

Investment Association expectations: The IA issued its annual update to its remuneration principles in November 2017. Although the changes to the principles themselves were relatively minor, the IA highlighted several areas of emphasis for its members:

- *Level of remuneration:* The IA requests companies to show restraint on increases in director pay (even if this is only an inflationary increase in salary) and to consider whether decreases are appropriate. The IA also reminds companies that their director pay must be justifiable in the wider social context of executive pay and that companies should not solely be considering benchmarking to justify pay levels.
- *Remuneration structures:* The IA does not advocate any one type of remuneration structure or the abolition of LTIPs in favour of restricted shares plans. Companies must choose the structure that is right for their business.
- *Shareholder consultation:* The importance of consultation with shareholders on executive pay is again an issue for the IA. Although the IA feels companies are improving their consultation practices, there remain concerns that this is sometimes seen as a "tick the box" exercise.

Companies are reminded that consultation should take place at an early stage and should be extensive rather than with a very select group of shareholders. In addition, the IA recommends that, as part of the consultation process, shareholders should be provided with details of the whole remuneration structure, not simply proposed changes, so that they can see the changes in context.

- *Pay for performance:* The IA's members are keen to see complete transparency in relation to performance targets and structures so that the link between pay and performance is clear.

ISS and IA Policies on Virtual Meetings

- The ISS has added a new policy to its UK/Ireland and European Voting Guidelines on virtual meetings. ISS will generally recommend FOR proposals that allow for the convening of hybrid shareholder meetings, and will generally recommend AGAINST proposals that allow for the convening of wholly virtual shareholder meetings.
- Echoing the position taken by the ISS, on 11 December 2017, the IA published a position statement on the use of wholly virtual AGMs. The IA's position is that its members will not support amendments to articles that allow for wholly virtual AGMs and expect any proposed amendment to confirm that the company would hold a physical meeting alongside any electronic meeting element. The IA will red top any company holding a wholly virtual meeting after changing its articles.
- Any company seeking to amend its articles to allow for both hybrid and wholly virtual meetings is advised to include an express statement in the notes to the resolution amending the articles that the company has no current intention of holding a wholly virtual meeting, rather than risk the resolution being voted down.

Performance conditions that apply to annual bonus and incentive plan awards are important in linking pay with performance. Two issues are on the agenda for 2018:

Financial performance targets

- Retrospective disclosure of financial targets should be made either when awards pay out or within 12 months if the disclosure is deemed commercially sensitive
- Disclosures should be full and include threshold, target and maximum targets

Personal and strategic performance targets

- For personal or strategic objectives, disclosure of the detailed rationale for the payment of these elements
- Where financial metrics have not been met, companies should expect more scrutiny of any payment
- Insufficient disclosure will lead IVIS to amber top the company's DRR

The minor changes to the principles themselves relevant for 2018 onwards included:

- *Relocation benefits:* Any benefits relating to the relocation of an executive director should be disclosed at the time of appointment, should be in place for a limited period which is disclosed to shareholders, and each element should be detailed in the DRR.
- *Annual bonus:* Deferring bonus into shares is expected for bonuses greater than 100% of salary.

LOOKING AHEAD

UK Corporate Governance Code: On 5 December, the FRC published for consultation its proposals for a "shorter", "sharper" Corporate Governance Code. This [consultation](#) follows on from the Government's response to its November 2016 Green Paper on corporate governance reform, in which the government asked the FRC to review and update the Code to (amongst other matters) require premium listed companies to adopt recommendations to strengthen the voice of employees in the boardroom. (For more information on the government's proposals on corporate governance reform, refer to our August 2017 briefing: [Government publishes watered-down corporate governance proposals](#).) The updated Code also reflects the recent update published by the Hampton-Alexander review on gender diversity and the work of the Parker Review in relation to ethnic diversity on boards.

Like the current Corporate Governance Code (the "**2016 Code**"), the draft Code continues to be built upon a series of principles, emphasising the value of good corporate governance, supported by more detailed provisions. An updated draft of *Guidance on Board Effectiveness* (last published in March 2011) has also been published, intended to assist companies in applying the principles of the Code. The Code continues to apply to premium listed companies, although it is worth noting that the exemptions for smaller companies (below FTSE 350) have been removed.

The draft Code is divided into five sections:

1. Leadership and Purpose;

Reporting on Directors' Compliance with Statutory Duties

- The Government is intending to publish secondary legislation by March 2018 to require all large companies (both public and private) to explain how their directors comply with the requirements of section 172 Companies Act 2006 (the duty to promote the success of the company for the benefit of the members, having regard to various factors, including the interests of certain other stakeholders (including employees) and the likely long-term consequences of any decision).
- The Government's initial view is that this requirement should apply to companies with more than 1,000 employees, although this is subject to further consultation.
- For premium listed companies, the proposed changes to the UK Corporate Governance Code discussed opposite, will require such companies to explain how they have engaged with stakeholders and how their interests and the matters set out in section 172 influence their board decision making, creating an overlapping requirement with the proposed legislation.
- The expectation is that the legislation will come into effect by June 2018 and will apply to financial years beginning or after that date.

2. Division of responsibilities;
3. Composition, succession and evaluation;
4. Audit, risk and internal control; and
5. Remuneration.

The FRC has published a separate document (Appendix C) summarising the changes from the 2016 Code. Appendix C also lists those provisions that have been deleted from the 2016 Code.

Leadership and Purpose: In Section 1 of the draft Code, there are a number of new provisions which result from the Government's package of corporate governance reforms. Like the rest of the Code, these are on a "comply or explain" basis. In particular, there are new provisions requiring that:

- The board should place emphasis on the culture and value of the business, requiring directors to embody and promote the desired culture of the company, to monitor and assess culture to ensure behaviour throughout the business is aligned with the company's values and to take corrective action where required. Such activities and actions should be explained in the annual report (draft Provision 2).
- A company should establish a method for gathering the views of the workforce which would normally be by means of a director appointed from the workforce, by the creation of a formal workforce advisory panel or by designating a non-executive director to do so (draft Provision 3), although the updated draft Guidance indicates that these are not the only methods and the board should be open to innovative alternatives if they would be effective.
- Companies should establish whistle-blowing procedures that allow for the workforce to raise concerns in confidence and anonymously, and ensure that arrangements are in place for investigation and follow-up of those matters (draft Principle D and Provision 3). Companies should foster an environment in which the workforce feels it is safe to voice their views (paragraph 34, draft Guidance).
- The board should explain in the annual report how it has engaged with the workforce and other stakeholders, and how the interests of the workforce and other shareholders and the matters set out in section 172 of the Companies Act 2006 (directors' statutory duties) influence the board's decision making (draft Provision 4). Please note that, in September 2017, the Institute of Chartered Secretaries and Administrators and the Investment Association published [guidance on board engagement with stakeholders](#) which is intended to help boards understand and weigh up the interests of their key stakeholders when taking strategic decisions.
- On receiving a vote of more than 20% against any resolution, companies still should explain, when announcing voting results, what actions they intend to take to consult shareholders to understand the reason behind the vote (reflecting 2016 Code Provision E.2.2). However, there is a new requirement to publish an update on such action within six months of the vote and for the board to then provide a final summary in the annual report on what impact the feedback has had on decision making (draft Provision 6).

Please note, separately, that the Investment Association has established a new public register of listed companies which have encountered shareholder

opposition of 20% or more on any resolution. This register aims to focus attention on those companies and to track whether and how they are addressing the concerns. The IA has written to all companies in the FTSE All-Share that received votes of 20% or more against any resolution (or that withdrew a resolution) in 2017, giving them the opportunity to provide an explanation of how they have addressed their shareholders' concerns. A link to each company's response will be included alongside its voting data when the register goes live at the end of 2017. As this information is already public, it is difficult to see what the register really adds. It is possibly a case of making it easier to monitor whether the measures designed to address significant shareholder dissent on pay are really working – the Government has said that it will consider further action if companies do not take active and effective steps to respond to shareholder concerns on pay.

Board responsibilities: It is worth noting some changes to the existing provisions on board composition which are now encompassed in Section 2 of the draft Code.

Draft Provision 11 states that independent non-executive directors, *including* the chair, should constitute the majority of the board. Under the 2016 Code, at least half the board, *excluding* the chair, should comprise independent non-executive directors (Provision B.1.2). In addition, the ongoing independence test will apply to the chair (draft Provision 15) whereas under the 2016 Code, the chair needed only to be independent upon appointment (Provision A.3.1). Accordingly, if a company determines that its chair is not independent, this may result in a situation where the company needs to appoint two additional independent non-executive directors to the board in order to ensure compliance with the Code.

In addition, the "presumption of independence" of a director set out in existing Provision B.1.1 is to be removed. Under the 2016 Code, the existence of certain criteria (for example, that the director has been an employee of the company within the last five years or has spent more than nine years on the board) are treated as factors that are relevant to determining whether a director is independent or not, but independence is ultimately a decision for the board. However, under draft Provision 15, the existence of any of such criteria would mean that a director could not be considered independent.

The draft Code also provides that board appointments and succession plans should promote diversity of gender, social and ethnic backgrounds, reflecting the recommendations of the Parker and Hampton-Alexander reviews (Section 3, draft Principle J). With regard to the nomination committee, there is a new requirement for a minimum membership of three, comprised of a majority of independent non-executive directors. The nomination committee is also expected to lead on succession planning not just for the board, but also for senior management (draft Principle J).

Remuneration: Also reflecting the recommendations of the Government's review of corporate governance, Section 5 of the draft Code contains new provisions that:

- The chair of the remuneration committee will be expected to have at least 12 months' prior experience of serving on a remuneration committee. In addition, the chair of the board may only be a member of the remuneration committee if he or she is independent (draft Provision 32).
- The remit of the remuneration committee should be expanded to cover not just board and senior management remuneration but to oversee all

New Payment Reporting and Gender Pay Gap Regulations

- Also on the horizon are the new Reporting on Payment Practices and Performance Regulations 2017, requiring large companies to publish specified information about the payment of their suppliers, and the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017, which will require companies with more than 250 employees to publish certain information annually, including the difference in mean and median gross hourly pay and bonus pay between male and female employees.
- The payment reporting regulations came into force in April 2017 and apply to financial reporting years starting on or after 6 April 2017. For companies with a 31 December year end, their first payment reporting statement will need to be published on a designated government website by 30 July 2018 in respect of the period from 1 January – 30 June 2018.
- With regard to gender pay gap reporting, affected employers must analyse their gender pay gap every April, and publish a gender pay gap report, and an accompanying written statement of accuracy, within 12 months. The report must be published on the company's website, and be kept publicly available online for three years. The report must also be uploaded to a government website. The first reports are required to be filed by no later than 4 April 2018, based on a snapshot of pay data as at 5 April 2017.
- Further information on both the payment reporting regulations and gender pay gap regulations can be found in our briefing, *Corporate Update*, to be published in January 2018.

remuneration and other employee-related policies and to take these into account when setting the policy for director remuneration (draft Provision 33).

- The recommended minimum vesting and post-vesting holding period for executive share incentives should be extended from three to five years to encourage a focus on longer-term outcomes when setting pay (draft Provision 36). Given that many listed companies have already moved to a five-year share awards (3 year vesting + 2 year holding), this should not make too much difference to listed companies in practice.

Draft Provision 41 sets out the requirement for the remuneration committee to include a description of its work in the annual report and includes a requirement for an explanation of what workforce engagement has taken place to explain how executive remuneration aligns with the wider company remuneration policy.

Principle Q makes clear the importance of the board exercising its independent judgement and discretion when approving remuneration outcomes. This principle is supported, in draft Provision 37, by a recommendation that remuneration schemes and policies provide boards with the discretion to override formulaic outcomes.

Separately, please note that, as part of the Government's package of corporate governance reforms, legislation is to be brought forward in the spring to require large listed companies to disclose the ratio of CEO v employee pay, being the ratio between CEO pay (currently proposed to be taken from the single figure in the DRR) and the average pay of all UK employees. Companies will also need to publish a narrative explaining changes in the ratio from year to year plus how the ratio relates to pay and conditions across the wider workforce. It is expected that this requirement will apply to financial years starting on or after June 2018. Not unsurprisingly, this proposal has found favour with many institutional shareholder and advisory bodies and it is something that the IA advocates companies adopt early on a voluntary basis. Details, including on how the ratio should be calculated, will become clearer when the draft legislation is published.

Next steps: The FRC's consultation closes on 28 February 2018. The FRC intends to publish a final version of the draft Code by early summer 2018 which will apply to financial years beginning on or after 1 January 2019.

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