PENSIONS AND LIFETIME SAVINGS ASSOCIATION

STEWARDSHIP & VOTING GUIDELINES 2024

ABOUT US

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintech's and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

ACKNOWLEDGEMENTS

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INTRODUCTION

While the Covid-19 pandemic seems a distant memory for some, Governments have been reeling from the event and some are now looking for new sources of capital to help bolster their economies.

This has led to environmental, social and governance (ESG) factors and sustainability considerations being deprioritised from the UK Government's current political agenda over the last year, to give way to a focus on maximising investment return and growth objectives.

In tandem with wider political shifts in priorities and objectives, the Financial Conduct Authority (FCA) has also proposed a series of new measures which, many of our members believe, will lead to a dilution of shareholder rights and a race to the bottom when it comes to stewardship practices. Changes which contrast with the increasing expectations placed on schemes to exercise their stewardship responsibilities to influence good market practice.

While recognising the importance of facilitating economic growth in the UK, we urge investors and companies to do this in tandem with responsible investment. One of the main ESG objectives is to generate more sustainable value creation for companies and investors, and the green transition also represents the most significant global growth opportunity over the coming decades.

This is one of the reasons why we have updated our Voting and Stewardship Guidelines with a brand-new section on social factors, highlighting the work conducted by the Taskforce for Social Factors, while also continuing to have a spotlight on workforce and well-being practices.

At a time where there is serious political unrest in several parts of the world, it is more important than ever for companies to have consistent policies on cybersecurity. The advent of AI, and how it can and will transform businesses, is also taken into consideration in the 2024 edition.

In a year marked by severe wildfires, floods and other natural disasters, the impact of human activity on biodiversity continues to be of extreme importance. Investors and companies have a crucial role to play in the transition to sustainable business practices.

As the cost-of-living crisis continues in the UK, a spotlight remains on Executive Pay, which is explored in this document.

These and other topics are covered in our 2024 Stewardship and Voting Guidelines, which continue to set out a comprehensive framework on how key issues need to be considered by schemes in their stewardship.

PURPOSE OF THIS GUIDE

This guide is aimed at scheme investors, their investment service providers and companies interested in using the PLSA's guidelines as a benchmark for their corporate reporting and investor relation work. The principles set in this document, although drafted for a UK context, are globally applicable, and schemes may wish to apply this framework more broadly than just to their holdings in UK equities.

Below is an outline of key sections of the document:

- *The Policy Framework for Corporate Governance and Stewardship* – Reviews the new regulations on shareholder engagement and its implications for scheme investors. It also discusses how corporate governance and stewardship relate to one another.

- *A Holistic Approach to Stewardship* – Explains what stewardship and engagement are, as well as outlines key considerations for schemes building effective stewardship, engagement and voting policies. This section includes practical checklists.

- *The PLSA's Corporate Governance Policy* – Sets out what investors should look for when it comes to assessing corporate behaviour and governance overall. It seeks to address the overall question of "what does good corporate behaviour look like?"

- *The PLSA's Voting Guidelines* – Delves into each of the key issues of interest to investors (such as audit, remuneration, climate change and workforce) and explores what investors should look for from companies, further exploring what good corporate behaviour looks like. It also discusses where investors might find evidence or metrics to inform decisions.

- *The Appendices* – These provide a chart summarising the PLSA's voting recommendations, both by issue and action, and a section with further reading and resources.

Considering this guide has been published for more than a decade now, and that most pension practitioners will be familiar with the static sections of the document, the PLSA decided to host these on its website.

Nevertheless, if you are just starting on your stewardship journey, we recommend reading the static chapters before delving into the Voting Guidelines.

SIGNIFICANT DEVELOPMENTS IN 2023

GREEN FINANCE STRATEGY

In March, the UK Government published its 2023 Green Finance Strategy,[1] updating its 2019 document, aiming “to strengthen the UK’s position at the forefront of the rapidly growing global green finance market, while driving private investment to deliver our energy security, net zero and environmental objectives.”

Key announcements from the strategy include:

- A review of the regulatory stewardship framework – including the Stewardship Code – which will be conducted by the FRC, working with FCA, DWP and TPR.
- The Government commits to consulting on the introduction of requirements for the UK’s largest companies to disclose their transition plans, supported by the Transition Plan Taskforce framework.
- Government to launch a call for evidence on Scope 3 greenhouse gas (GHG) emissions reporting, to better understand the costs and benefits of producing and using this information. Call for evidence was launched in October and closed in December.
- Government will deliver a UK Green Taxonomy – a tool to provide investors with definitions of which economic activities should be labelled as green. After the Taxonomy has been finalised, Government will initially expect companies to report voluntarily against it for at least two reporting years, after which it will explore mandating disclosures.

CORPORATE GOVERNANCE CODE

In May, the Financial Reporting Council announced a limited revision of the Corporate Governance Code,[2] following the Government's response to the White Paper, “Restoring Trust in Audit and Corporate Governance”,[3] which identified areas of reform related to a particular focus on directors' responsibilities for internal control, risk, audit and corporate reporting.

Following feedback and engagement with industry, the FRC announced in November[4] that it would be only taking forward a small number of the original 18 proposals set out in the consultation and to stop development of the remainder. At the time, the government wrote to the FRC to update their remit and outlined that while their core responsibility is still to enhance public trust and

[1] HM Government, ‘Mobilising Green Investment 2023: Green Finance Strategy’ HM Government (2023) <https://assets.publishing.service.gov.uk/media/643583fb877741001368d815/mobilising-green-investment-2023-green-finance-strategy.pdf>.

[2] Financial Reporting Council ‘UK Corporate Governance Code: Consultation document’, Financial Reporting Council (2023) <https://media.frc.org.uk/documents/Corporate_Governance_Code_Consultation_document.pdf>.

[3] Department for Business, Energy & Industrial Strategy ‘Restoring trust in audit and corporate governance’, Department for Business, Energy & Industrial Strategy (2022) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1079594/restoring-trust-in-audit-and-corporate-governance-govt-response.pdf>.

[4] Richard Moriarty ‘Statement: FRC policy update’, Financial Reporting Council (2023) < https://www.frc.org.uk/news-and-events/news/2023/11/statement-frc-policy-update/>.

confidence in the quality of audit, corporate reporting and governance, this should be done in a way that supports the UK's economic growth and international competitiveness.

On 22 January 2024, the FRC published its revision[5] to the Code. The changes made have been limited with the focus on promoting smarter regulation and better governance through revisions to the Code in Internal Controls. The comply or explain regime means companies do not have to adhere strictly to the rules if they can provide a rationale as to why.

The new 2024 Code will apply to financial years beginning on or after 1 January 2025. Until then the 2018 Code will apply.

FCA PRIMARY MARKETS REVIEW

Due to concerns around the long-term decline in number of UK listed companies, which has fallen by 40% since 2008, the FCA launched a consultation[6] in May proposing to replace standard and premium listing share categories with a single listing category for commercial company issuers of equity shares.

Among the new proposals, asset owners were concerned with a new dual class share structure, the removal of shareholder approval for significant transactions and related party transactions, considering these changes would weaken shareholder rights by removing some important checks and balances.

In December, the FCA responded to the consultation,[7] publishing detailed rules for a simplified listing regime with a single listing category. Whilst the FCA have acknowledged asset owners' concerns, it has broadly maintained the approach set out in the first consultation.

VOTE REPORTING TEMPLATE

The Vote Reporting Group, established by the FCA in November 2022 to address the recommendations of the Taskforce on Pension Scheme Voting Implementation (TPSVI), published a consultation and discussion paper[8] in June proposing a voluntary, standardised and comprehensive 'vote reporting template' for asset managers to communicate to asset owner clients on their voting activity.

The consultation closed in September and the FCA, acting as Secretariat, will be reviewing responses and submitting a summary to the Vote Reporting Group.

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5 Financial Reporting Council 'UK Corporate Governance Code', Financial Reporting Council (2024) <https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2024_FF6VFzi.pdf>.

6 Financial Conduct Authority 'Primary Markets Effectiveness Review: Feedback to DP22/2 and proposed equity listing rule reforms', Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/consultation/cp23-10.pdf>.

7 Financial Conduct Authority 'Primary Markets Effectiveness Review: Feedback to CP23/10 and detailed proposals for listing rules reforms', Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/consultation/cp23-31.pdf>.

8 Vote Reporting Group 'Vote Reporting: A consultation and discussion paper from the Vote Reporting Group', Vote Reporting Group (2023) <https://www.fca.org.uk/publication/consultation/vote-reporting-consultation-discussion-paper.pdf>.

FCA DIVERSITY AND INCLUSION FRAMEWORK

In September, the FCA launched a consultation[9] on diversity and inclusion (D&I) in the financial sector. They set out proposals for what they describe as a flexible and proportionate D&I regulatory framework for FCA firms. The stated objectives are to achieve healthier firm cultures, reduce groupthink, increase diversity of talent and a greater understanding of and provision for diverse consumer needs.

The proposals would see all firms required to meet minimum standards to carry on regulated activities by embedding rules around diversity and inclusion into fitness and propriety rules, the code of conduct and the threshold conditions. In addition, large firms would have additional reporting and disclosure requirements as well as requirements to create evidence-based D&I strategies and set targets to drive progress. The consultation closed in December.

TASKFORCE ON NATURE-RELATED FINANCIAL DISCLOSURES

In September, the Taskforce on Nature-related Financial Disclosures (TNFD) published its final Recommendations[10] for nature-related risk management and disclosure. Additional guidance was also released, aimed at helping market participants get started with integrated assessment and corporate reporting related to nature.

The Recommendations aim to inform better decision making by companies and capital providers, intended to serve as a starting point for companies to begin identifying, assessing and disclosing the nature-related issues in their own time, and subject to their own strategy, materiality, cost and capability considerations.

The TNFD will now encourage and support voluntary market adoption of the Recommendations, and it will track voluntary market adoption on an annual basis through an annual status update report beginning in 2024.

TASKFORCE ON SOCIAL FACTORS

In October, the Taskforce on Social Factors (TSF) published a guide[11] including more than 30 recommendations aimed at providing pension trustees with the tools to identify and monitor social risks and opportunities, while developing consensus in approaching these across the pension

[9] Financial Conduct Authority 'Diversity and inclusion in the financial sector – working together to drive change', Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/consultation/cp23-20.pdf>.

[10] Taskforce on Nature-related Financial Disclosures 'Recommendations of the Taskforce on Nature-related Financial Disclosures', Taskforce on Nature-related Financial Disclosures (2023) <https://tnfd.global/wp-content/uploads/2023/08/Recommendations_of_the_Taskforce_on_Nature-related_Financial_Disclosures_September_2023.pdf?v=1695118661>.

[11] Taskforce on Social Factors 'Considering Social Factors in Pension Scheme Investments: Guide from the Taskforce on Social Factors', Taskforce on Social Factors (2023) <https://www.taskforceonsocialfactors.co.uk/siteassets/shared-media/images/uk_social_factors_consultation_v4.pdf>.

investment landscape. The guide and its recommendations (which are explored in Section 7 of this document) were object of an industry consultation which closed on 1 December 2023.

The TSF was launched in February 2023 as a result of the DWP consultation on the consideration of social risks and opportunities by occupational pension schemes. The Taskforce aims to support pension scheme trustees and the wider pensions industry with some of the key challenges around managing social factors, including the identification of reliable data and metrics.

TRANSITION PLAN TASKFORCE

In October, the Transition Plan Taskforce (TPT) - established by Government in 2022 to develop the ‘gold standard’ for climate transition plans - published its finalised Disclosure Framework[12] and supporting guidance. The package of publications was designed to ensure that entities take a ‘strategic and rounded approach’ in developing a transition plan that explains how climate-related targets will be met, how climate-related risks are managed, and how it contributes to achieving net zero.

The TPT also published a range of supporting implementation guidance, including a sector summary that outlines decarbonisation levers and metrics and targets for 40 sectors, which was open for industry comment until 24 November. In November, the TPT published seven pieces of sector deep dive guidance for consultation - covering asset managers, asset owners, banks, food & beverage, electric utilities & power generators, metals & mining, and oil & gas - which closed at the end of 2023.

SUSTAINABILITY DISCLOSURE REQUIREMENTS

In November, the Financial Conduct Authority (FCA) announced its Sustainability Disclosure Requirements[13] and an investment labels regime, with the aim to support the UK as a leader in sustainable investment and to protect consumers by enhancing the credibility of the market.

The FCA will introduce an anti-greenwashing rule for all authorised firms to make sure sustainability-related claims are fair, clear and not misleading, which comes into force from 31 May 2024. Product labels to help investors understand what their money is being used for, based on clear sustainability goals and criteria, can be used by firms from 31 July 2024. Naming and marketing requirements, so products cannot be described as having a positive impact on sustainability when they do not, will come into effect from 2 December 2024.

[12] Transition Plan Taskforce ‘Disclosure Framework’, Transition Plan Taskforce (2023) <https://transitiontaskforce.net/wp-content/uploads/2023/10/TPT_Disclosure-framework-2023.pdf>.

[13] Financial Conduct Authority ‘Sustainability Disclosure Requirements (SDR) and investment labels’, Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/policy/ps23-16.pdf>.

SECTION 1: BOARD LEADERSHIP AND COMPANY PURPOSE

An effective board is crucial to setting a positive company purpose, set of values and culture. The board should be diverse and committed to contributing to the long-term success of the company and the boardroom culture must enable each Director to contribute effectively and create a whole greater than the sum of its parts.

Company leadership, purpose and culture vary widely, and investors should work with their advisers and managers to consider which issues are the most likely to be material to value-generation. For instance, one company might have an issue with its supply chain and another an issue with staff retention.

THE ROLE OF CULTURE

The Covid-19 pandemic ushered in a new era of how we look at company culture and the treatment of workforces.

Cultural failures can damage corporate reputation and substantially affect investment returns. The 2018 UK Corporate Governance Code clearly highlighted the role of the board in determining and assessing a company's culture and values, and how the desired culture has been embedded.

Culture is difficult to assess, but there are performance metrics available that can be helpful for raising key questions. The PLSA has undertaken work[14] to determine the value of an engaged, motivated and skilled workforce through a range of proxy metrics. The aim is for investors to use this to assess its company culture through different sources of information, including their communications with employees, shareholders and wider stakeholders.

EVIDENCE BASE

Shareholders will naturally look at financial results and wider evidence that the Chair and the board are adhering to the spirit of the Corporate Governance Code's Principles. For instance, significant pay discrepancies between a company's senior executives and the rest of the workforce, as well as gender or ethnicity pay gaps, can be signifiers of wider issues within a workplace's culture and processes.

To ensure a strong and inclusive workplace culture, clarity on company strategy, culture and the business model should flow through every part of the Annual Report. This should include information on a company's employment model and working practices – given their significance to a company's long-term performance – and how this is linked to the firm's culture and purpose.

[14] Pensions and Lifetime Savings Association 'Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds', Pensions and Lifetime Savings Association (2016) <https://www.plsa.co.uk/portals/0/Documents/0591-Understanding-the-worth-of-the-workforce-a-stewardship-toolkit-for-pension-funds.pdf>.

The Annual Report should have clear information on workforce engagement as well as draw clear links between any employee survey findings, actions undertaken in response to this and the expected impact. Key measures include employee turnover and employee survey follow-up. Additionally, a company's Strategic Report should clearly articulate how its key assets contribute to the generation of sustainable value creation. Clear connections should be apparent between chosen financial and non-financial priorities and KPIs selected by the company. Outcomes for the company and its stakeholders should be measurable, incentivised, and integrated into remuneration arrangements, with appropriate outcome measures over a reasonable time horizon.

Shareholders may want to undertake a closer analysis of the narrative within company statements, noting the tenor and language used in describing the approach to the workforce and stakeholders. In addition, this analysis should consider whether messaging from the Chair and Chief Executive (CEO) statements are clear regarding the aims and culture of the company. A feeling of alignment and consistency should be apparent throughout the document.

Leadership purpose and culture can be difficult to evaluate purely through reading company reports and therefore should be enhanced by shareholder engagement, which is central in reviewing corporate behaviour and assessing performance on an ongoing basis.

The best indicators to use will depend on the situation, the context and the specific environment in which a company operates. Investors should look for reliable and consistent sources of data, which allow comparison with others in the sector over time.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Corporate purpose, culture and values are aligned with company strategy. This alignment should continue through the recruitment, performance management and reward structures, all of which should be aimed at incentivising behaviour that is consistent with the company's purpose and values.
- There is a clear link between good performance, the effectiveness of the board and results that are consistent with the company's stated strategy. Any weakness in performance should be adequately explained and addressed and should not be the result of imprudent management, poor judgement or weakness in corporate governance. It should rather be the result of external factors over which the board has limited control, but which it is taking steps to combat, nonetheless.
- Boards demonstrate awareness of their s.127 Duties under the 2006 Companies Act.[15] This is a requirement for Directors to have regard to other stakeholders, including workers, customers, suppliers as well as the wider society and environment. This should include evidence of a plan for engagement with stakeholders, as well as activities undertaken and consequent outcomes.
- Boards demonstrate positive relationships with key stakeholders. Boards should be able to communicate how stakeholder perspectives are fed into boardroom considerations, which

[15] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents>.

should include shareholders - the quality of this dialogue is vital for assessing culture especially.

- The Annual Report offers a fair, balanced and understandable assessment of the company's prospects and position. It should cover both financial and non-financial issues and outline how the board has fulfilled its responsibilities.
- Company statements refer to the workforce as a source of value, not a risk to be managed. The 2018 Corporate Governance Code explicitly clarified a company's responsibilities to shareholders and stakeholders, including its workforce.
- The Chair is engaged with the company's shareholders on governance and culture. The Chair should be accessible, accept legitimate shareholder requests for meetings and convey relevant sentiments and dialogue back to the Board.
- Governance reporting is focused on board decisions and their outcomes in the context of the company's strategy and objectives. Where the board reports on departures from the Code's provisions, it should provide a clear explanation.[16]

HOW INVESTORS SHOULD CONSIDER VOTING

The most appropriate route for voicing general concerns is through voting on the Annual Report and Accounts. Investors should consider **voting against adoption of a company's Annual Report and Accounts** if:

- Key stakeholder relationships, including with shareholders and the workforce, are being neglected and the board is not adhering to the spirit of the Corporate Governance Code requirement to engage and support stakeholder constituencies.
- Disclosure of the business model fails to convey how the company intends to generate and preserve long-term value.
- The company fails to provide a fair and balanced explanation of the composition, stability, skills and capabilities and engagement levels of the company's workforce.

More specific concerns related to the quality of the company's interaction with shareholders could be addressed by **voting against the re-election of the Chair** if:

- The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason as to why or has failed to find a mutually convenient time without undue delay.
- The Chair has repeatedly failed to address investors' concerns about the relationship between the company and key stakeholders.
- The Chair has had significant involvement, whether as an Executive Director or a Non-Executive Director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.

[16] New Corporate Governance Code 2024 principle which comes into force on 1 January 2025.

SECTION 2: DIVISION OF RESPONSIBILITIES

SEPARATION OF THE ROLES OF THE CHAIR AND CHIEF EXECUTIVE

A key role for the board is to scrutinise the operations and strategy of a company, ensuring the firm is operated in a way which aligns with its mission, purpose and in the interests of stakeholders. An important element of this is holding company management – including the CEO – to account.

Separation of the roles of the Chair – who should be transparently independent – and the CEO is therefore a cornerstone of good corporate governance in the UK. The contravention of this tenet by (a) the combination of the roles, or (b) the designation of an Executive Chair, should cause significant concern.

There are very limited instances where a temporary combination of the roles may be justified, notably when a Chair "bridges the gap" between the departure of a CEO and the appointment of their successor. Investors must probe companies carefully in these instances, ensuring that this short-term fix is being well-managed and that it does not persist excessively.

The succession of the CEO to Chair is a significant issue and is very rarely acceptable. It must be made clear that external search consultants were engaged and that external candidates of at least equivalent stature had been actively and fully considered.

BOARD DIRECTOR COMMITMENT

The board Director role is an increasingly demanding one, particularly when chairing a key Committee. It is crucial that Directors have sufficient time and energy to fulfil their role properly.

BOARD DIRECTORS AND CHAIR INDEPENDENCE

This calls for a particularly thoughtful application of the "comply or explain" principle. Investors should consider the following factors in coming to their decision regarding independence:

- Overall corporate governance standards and history.
- Evidence of independence in board Directors' conduct, including holding management to account when necessary.
- Confirmation that independence (not just performance) was assessed in the board performance review.

EVIDENCE BASE

Engagement with board Directors, particularly the Chair, gives investors the opportunity to assess the quality and effectiveness of the board overall. A company's Annual Report is a key resource for investors to consider, as it provides important information regarding the division of responsibilities of the board.

The Annual Report should contain details of current leadership appointments, including any changes over the previous year. Investors should be mindful of the separation of the roles of Chair and CEO, as well as the other commitments and interests that board Directors' may have in forming their views, including their concurrent directorships, while taking into account of the size and scope of these outside companies, as well as whether an individual board Director is over-committed.

The Annual Report should also clearly set out the ways in which the board has demonstrated its effectiveness and addressed any areas for improvement. This should include insight into board-level training and assessment and outreach activities that have taken place throughout the year. It should also include an assessment of the board's diversity of skills, experience and backgrounds.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Different roles and individuals within the board work together collectively and effectively. The quality and mix of individuals should give investors reassurance as to the substance and openness of debate within the boardroom, the lack of dominance by any one individual and the avoidance of groupthink.
- The roles of Chair and CEO are fulfilled by different individuals. The two roles are distinctly different and should not, unless in exceptional circumstances, be held by the same person. Clear timescales for the persistence of any redundancy within these roles should be set out. Similarly, a company's CEO should not become Chair of the company. We would expect significant levels of engagement with shareholders were this to be the case, setting out the reasons for doing so.
- The Chair is transparently independent, and – upon new appointments – confirmation is provided to shareholders that the previous Chair was not involved in the appointment of their successor. If the Chair is not independent upon appointment, the company should consult its investors and provide a detailed explanation as to why it considers the appointment desirable and appropriate. In assessing the new Chair's suitability, shareholders must consider:
    - Their calibre, including skills, knowledge and experience
    - The current balance and diversity of the board
    - The nature of the impediment to the proposed Chair's independence.
- The Nomination Committee anticipates change and ensures proper and timely succession planning. Boards should endeavour, where feasible, to consult their long-term investors over sensitive board appointments.
- Directors can commit appropriate time to the company. Investors should assess the evidence for other demands on Directors' time as well as any significant developments which may have occurred since a Director's appointment.
    - This is particularly pertinent to the role of Chair, especially where a company is both complex and global in scale or where it operates in a highly regulated sector (such as financial services).
    - It is clear that due consideration has been given by the board and each Director to the time commitment required, particularly in the event of a crisis developing.

- Clear mechanisms are in place for shareholder communication. This must include the appointment of a Senior Independent Director (SID) as a key contact for shareholders when the normal channels of the Chair, CEO, or Chief Financial Officer have failed to address concerns or are not the appropriate contact.
- Shareholders are given timely access to online terms and conditions by which Directors are appointed.
- No current or prior relationships exist between Independent Non-Executives and the company, which could compromise Directors' ability to hold management to account. Shareholders should have a clear sense of any existing or pre-existing relationships between the two parties. The Corporate Governance Code draws out more clearly its expectations regarding this area.
- There should be a clear mechanism in place for a company's engagement with its wider workforce. Companies should be clear about linking their engagement with their workforce to their broader strategy, values and mission.

HOW INVESTORS SHOULD CONSIDER VOTING

We are aware that investors may feel uncomfortable voting against a combined CEO/Chair given the pivotal role that a CEO plays in a company (and the investment case). Some investors may therefore choose to vote against the Annual Report and Accounts to signal their concern, short of opposing the combined CEO/Chair.

However, we feel that this may not be a sufficiently effective response to what is a very serious issue. We therefore believe that **investors should consider voting against the election of the Chair** if:

- There is a combination of the role of Chair and CEO without a convincing explanation as to why, where an 'interim' period extends for more than one year or where there is evidence of poor succession planning.
- Investors judge that the arguments presented to justify the succession of the CEO to Chair are insufficient. It is important to note that complexity of the business is unlikely to be sufficient explanation in itself.
- The Chair is Director of more than four companies and/or a Chair of two or more global and highly complex companies (unless there is a compelling explanation as to why this will not impact their availability and commitment).
- The situation of a combined role persists and there remains serious concern that the specific arrangements create unresolvable challenges for board oversight of executive management.
- Material corporate governance failings under the Chair's watch are evident. This should include an inadequate response in addressing shareholder concerns.
- Investors should consider also voting against the election of the Director responsible for the appointment process (often the SID) when issues persist.

SECTION 3: COMPOSITION, SUCCESSION AND EVALUATION

COMPOSITION AND DIVERSITY

There is clear evidence that diverse boards make better decisions and avoid behavioural biases such as groupthink or herding, enhancing board effectiveness. Although there is evidence of progress on UK boards regarding gender and ethnic diversity, more work remains to be done. Investors must continue to press companies to maintain momentum, set clear timescales, and assess company disclosures on diversity carefully.

The FTSE Women Leaders Review,[17] which sets recommendations for Britain's largest companies to improve the representation of women on boards and in leadership positions, and carries on the work from the Hampton-Alexander and Davies Reviews, found that women's representation on FTSE 100 Boards increased from 39.1% to 40.5% between 2021 and 2022, and from 36.8% to 40.1% for FTSE 250 Boards during that same time. Great progress was made by FTSE 350 Boards, which reached the 40% goal for women on boards three years ahead of the target date of 2025. Progress is still needed on other objectives, such as women occupying at least one of four roles of Chair, Senior Independent Director, CEO and Chief Financial Officer, with 43 of the FTSE 100 companies meeting this target.

According to the latest March 2023 report from the Parker Review[18] on the ethnic diversity of UK boards, a key target was nearly met, with almost each FTSE 100 Board having at least one Director from a minority ethnic group by the end of 2022. In the FTSE 250, progress is also being made towards the 2024 target, with 67% of companies that responded meeting the target in 2022, up from 55% last year. Two new targets were also set for December 2027, with each FTSE 350 company being asked to set a percentage target for senior management positions that will be occupied by ethnic minority executives, and 50 of the UK's largest private companies have been set the target of having at least one ethnic minority director on the main board.

SUCCESSION AND BOARD PERFORMANCE REVIEW

Continuous board refreshment and succession planning are vital to ensure diversity on boards. It is critical that appropriate and sufficiently flexible succession plans are in place for the CEO and Chair.

An effective board performance review process will use an independent external facilitator at least every three years.

[17] FTSE Women Leaders 'FTSE Women Leaders Review: Achieving Gender Balance', FTSE Women Leaders (2023), <https://ftsewomenleaders.com/wp-content/uploads/2023/02/2022-ftse-women-leaders-review-final-report.pdf>.

[18] David Taylor & The Parker Review Committee 'Improving the Ethnic Diversity of UK Business: An update report from the Parker Review' (2023) <https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/topics/diversity/ey-parker-review-report-2022.pdf>.

EVIDENCE BASE

While it is particularly difficult to obtain concrete metrics in this area, investors should look for progress over time and evidence that the company's approach is improving diversity.

Company disclosures on succession planning tend to use boilerplate reporting. Investors should look at the Annual Report with an eye towards assessing how bespoke the narrative on succession planning is, including how well it is linked to the company's overall strategy, values and mission.

Best practice disclosure on this issue includes:

- A board succession planning and nomination policy
- A rationale for re-election of each Director
- Disclosure about the principles and process, including clearly defined parameters for and expectations of new appointments
- Disclosure regarding the diversity of the board on a "comply or explain basis," including a clearly defined process for developing diversity. A clear discussion regarding the outcome of the board effectiveness review, including how the findings impact upon broader company value.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- The board has a clear vision about its optimal composition and a structured plan and timescales to achieve this. This should include: the ideal mix of experience and skills; gender, ethnicity and other forms of diversity including but not limited to those protected characteristics detailed in the Equality Act 2010;[19] and the proportion of the board that should consist of Non-Executive Directors.
- Clear disclosure on succession plans. While some allowance should be made for the confidential or sensitive nature of some succession planning issues, disclosures should cover as much material information as possible including:
    - Any identified skills shortages or obstacles/delays to achieving diversity goals
    - A focus on the Chair and CEO
    - An approach which looks out over multiple years.
- Ownership of the succession planning approach by the company. The board should – through the Nomination Committee – retain ownership over the succession planning and recruitment strategy for both the board and for the Senior Management Team. Although the company may use external consultants, the board should ensure it remains actively involved.
- A well-balanced Nomination Committee. This should include the Non-Executive Chair of the board, given the vital role they play in Director performance evaluation.
- A clear and convincing rationale for board Director re-election in the Annual Report. Such a statement should present shareholders with a full picture of the relevant and diverse skills and experience that a Director is bringing to the board. It should also include:

[19] Equality Act 2010, The Stationary Office <https://www.legislation.gov.uk/ukpga/2010/15/section/4>.

  - A statement of a Director's other directorships, trusteeships and responsibilities – including those outside the corporate sector
  - The contributions they have made or will likely make to the board, including how their unique background helps shape a diverse board
  - Confirmation that the Director has recently been subject to formal performance evaluation in relation to the fulfilment of their S.172 duties.[20]
- Detailed and considered explanations around Director independence. This should include why the company considers that the Director remains independent despite the existence of any factors which may impair independence. It should also include justification as to why the independent element is sufficiently strong to counter any imbalance that may arise from the presence of one (or more) Non-Independent Non-Executive Directors.
- A transparent and inclusive approach to the nomination process. This should include engagement with key shareholders, or other stakeholders such as employees.
- A consistent approach to board refreshment. This should include appropriate Director mandates in terms of duration, and a clear link between Director performance and re-election.
- Forward-looking and detailed succession and refreshment plans when proposing the re-election of long-serving members. The Corporate Governance Code stipulates that a board should state its reasons if a Director has more than nine years' tenure. This should not be considered to mark a limit on the value offered by an individual, but a detailed plan is particularly vital when the Director chairs an important Board Committee, including the following:
  - There is evidence of a particularly rigorous review and evaluation process in the cases of long-serving members
  - There is particularly clear disclosure as to why a long-serving Non-Executive Director remains independent.
- A clear link between implementation of the succession plan and company strategy. This should include the board's policy on diversity, inclusion and equal opportunities, including its diversity objectives and progress towards achieving them. There should also be clear information regarding the efforts to develop talent internally.
- A clear description of the board's policy on diversity and inclusion, including professional, international, and protected characteristics[21] such as: Sex, race, disability, age, sexual orientation, gender reassignment, marriage and civil partnership, pregnancy and maternity, and religion or belief. And other non-protected characteristics are also considered such as: Socio-economic background, neurodiversity, veterans and returners to workplace.
- Clear, measurable objectives that it has set for implementing its diversity policy, and its progress against these objectives. This should include the board's policy not just on its own diversity, but also on the diversity of the Senior Management Team. There should be a consistency in the company's strategy, and explanations of the contribution of diversity and its link to corporate value over time. This should include:

[20] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/172/2011-04-22>.
[21] Equality Act 2010, The Stationary Office <https://www.legislation.gov.uk/ukpga/2010/15/section/4>.

- Documentation of the gender and ethnic diversity of the board as well as its progress towards meeting minimum gender and ethnic standards as required by the FCA on all UK listed companies[22] on a comply or explain basis. These are:
  - Gender
    - At least 40% of the board are women (including those self-identifying as women).
    - At least one of the senior board positions (Chair, CEO, Senior Independent Director, or Chief Financial Officer) is a woman (including those self-identifying as women).
    - Note: The FTSE Women Leaders Review maintains both these standards and includes additional recommendations on ways to improve gender diversity. We strongly support working towards these additional metrics.
  - Ethnicity
    - At least one member of the board is from a non-White ethnic minority background (as referenced in categories recommended by the Office for National Statistics).
      - Note: The Parker Review maintains this equivalent standard with additional recommendations for improving ethnic diversity, and we recommend using this as a guide as well. Also, it is important to document whether they are a signatory to the Race at Work Charter (or equivalent).
    - Documentation on the board's efforts towards creating an inclusive workplace environment for those with disabilities. This could include whether they are a Disability Confident employer in the UK.
  - Note: In September 2023, the FCA consulted[23] on proposed changes to their approach to diversity and inclusion. The proposed framework would see all firms required to meet minimum standards to carry on regulated activities by embedding rules around diversity and inclusion into fitness and propriety rules, the code of conduct and the threshold conditions. For larger firms, the FCA propose more specific requirements around the development of D&I strategies, target setting and reporting and disclosure.
- External board performance reviews are conducted by a truly independent organisation, which is vital for an independent and rigorous approach. Companies should disclose details of the process – including the name of the firm or individual undertaking the board performance review – and as far as possible the conclusions reached within the review and subsequent actions taken. This should include details on the following:
  - When the review took place and when a subsequent review is planned

[22] Financial Conduct Authority 'Diversity and inclusion on company boards and executive management', Financial Conduct Authority (2022) <https://www.fca.org.uk/publication/policy/ps22-3.pdf>.

[23] Financial Conduct Authority 'Diversity and inclusion in the financial sector – working together to drive change', Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/consultation/cp23-20.pdf>.

    - What was specifically reviewed (including the rationale for this decision)
    - Who conducted the review, whether they were internal or external, appointments and why they were selected
    - The nature of the process
    - Key findings and lessons learned, and whether any follow-up is required and if so, in what areas.
- Disclosure of details of any controlling shareholders, including the relationship agreement. The relationship agreement must detail any entitlements to governance arrangements such as board appointments and be made available to investors, barring any commercially sensitive details.

HOW INVESTORS SHOULD CONSIDER VOTING

Holding individual Directors accountable is especially vital if schemes are particularly unhappy with the composition of a board of company, including the plans for succession and methods which have been used to ascertain how 'fit for purpose' an individual board member is.

Although voting against the entire board is usually the most powerful sanction an investor can apply, in this case, it is voting against specific individuals – alongside a clear and timely explanation from the investor as to why the vote is being cast – that can be most effective.

Investors should consider voting against the approval of the Annual Report and Accounts if:

- There is limited or boilerplate disclosure about the board performance review and review of corporate governance arrangements.
- A diversity statement is not disclosed or is considered unsatisfactory based on our above recommendations of what good company behaviour should be.

Investors should consider voting against the re-election of the Chair if:

- Practice does not improve regarding the composition and succession or there is consistently no independent board performance review conducted.

Investors should consider voting against the re-election of the Chair and the Chair of the Nominations Committee if:

- There is no evaluation process.
- There is a failure to disclose a reassuring succession plan, even after engagement with shareholders.
- The board is consistently failing to move closer to the latest FCA requirements on diversity and inclusion – or did not successfully explain the reason for non-compliance – the FTSE Women Leaders Review on gender diversity and the Parker Review recommendations on ethnic diversity.
- The board has not established a diversity and inclusion policy and strategy.

- The board is consistently failing to, or showing lack of effort to, move closer to our above recommendations of what good company behaviour should be regarding board diversity.
- There is a failure to move to annual Director elections and an absence of an acceptable explanation.

Investors should consider voting against the re-election of a Director (including re-election of the Chair) if:

- Previous legitimate investor concerns have not been sufficiently addressed.
- The Director has had significant involvement, whether as an Executive Director or Non-Executive Director, in material failures of governance, stewardship or fiduciary responsibilities at another company or entity.
- Engagement with a Director has resulted in a judgement against their effectiveness and suitability, including with regards to conflict of interest.
- There is no supporting statement from the board.
- There is clear evidence of poor performance or poor attendance at meetings without provision of a satisfactory explanation.
- There is concurrent tenure of a Non-Executive Director with an Executive Director for over nine years and no satisfactory explanation given as to why the Director remains independent.
- The composition of the key Committees or the balance of the board has been compromised by the presence of one (or more) specific non-independent Non-Executive Directors.
- There is failure of a specific aspect of reporting or function (with investors voting against the Director responsible e.g., the Chair of the relevant Committee).
- There is no clear evidence that diversity is being sufficiently considered by the board, or where previously committed timescales are not being met, in the senior board positions.

SECTION 4: AUDIT, RISK AND INTERNAL CONTROL

The primary client of a company's Auditor is the shareholder. Investors rely on a high-quality audit, where the Auditors are fully independent and have exercised professional scepticism and judgement, to enable them to form a clear and accurate view of the financial health of the company.

Individual accountability here is key: if a named partner, or the Chair of an Audit Committee, has been involved in presiding over poor audit practices elsewhere, then investors should expect that the individual is not involved on an Audit Committee or involved in the audit at or of another firm.

In 2021, the UK Government launched a major consultation on audit reform,[24] bringing together the recommendations of the Kingman Review,[25] the Competition and Markets Authority statutory audit market study,[26] and the Brydon Review.[27] Though the Government had committed in the 2022 Queen's Speech[28] to bring forward an Audit Reform Bill, this legislation was not included in the 2023 King's Speech.

A set of draft regulations to create a series of "new corporate reporting requirements for very large UK companies" were laid in Parliament on 19 July 2023, but these proposals were withdrawn on 16 October 2023, after a consultation with companies raised concerns about imposing additional reporting requirements. Instead, the Government will pursue options to reduce the burden of red tape, while remaining committed to wider audit and corporate governance reform, bringing legislation in this area when Parliamentary time allows.[29]

Nevertheless, the FRC published in May its Minimum Standards for Audit Committees[30], which are applicable – for now on a voluntary basis – to companies with a Premium Listing on the London Stock Exchange, and which are included within the FTSE 350 index. The goal is to enhance performance and ensure a consistent approach across audit committees within the FTSE350, while

[24] Department for Business, Energy and Industrial Strategy 'Restoring trust in audit and corporate governance – Consultation on the government's proposals', Department for Business, Energy and Industrial Strategy (2021) <Restoring trust in audit and corporate governance (publishing.service.gov.uk)>.

[25] Sir John Kingman 'Independent Review of the Financial Reporting Council', Department for Business and Trade, Financial Reporting Council and Department for Business, Energy & Industrial Strategy (2018) <Independent Review of the Financial Reporting Council (publishing.service.gov.uk)>.

[26] Department for Business, Energy & Industrial Strategy 'Market study on statutory audit services: summary of responses', Department for Business, Energy & Industrial Strategy <Market study on statutory audit services: summary of responses to the 2019 consultation (publishing.service.gov.uk)>.

[27] Sir Donald Brydon 'Assess, assure and inform: improving audit quality and effectiveness – final report of the independent review', Department for Business and Trade and Department for Business, Energy & Industrial Strategy (2019) <Independent Review into the Quality and Effectiveness of Audit (publishing.service.gov.uk)>.

[28] Prime Minister's Office 'The Queen's Speech 2022', Prime Minister's Office (2022) <Lobby Pack (10 May 2022) (publishing.service.gov.uk)>.

[29] Department for Business and Trade 'Burdensome legislation withdrawn in latest move to cut red tape for businesses', Department for Business and Trade (2023) <https://www.gov.uk/government/news/burdensome-legislation-withdrawn-in-latest-move-to-cut-red-tape-for-businesses>.

[30] Financial Reporting Council 'Audit Committees and the External Audit: Minimum Standard', Financial Reporting Council (2023) <https://media.frc.org.uk/documents/Audit_Committees_and_the_External_Audit_Minimum_Standard.pdf>.

the FRC aims to support the delivery of high-quality audits and reinforce public trust in the financial reporting process.

Recommendations from the Brydon Review, that investors may wish to consider, include:

- For the Directors' Risk Report to be published in good time for shareholders to comment, as well as for a formal invitation to be issued to shareholders to express any requests regarding where they would be particularly keen for an Auditor to focus on in the audit plan.
- A standing item to be added to AGM agendas for questions to the Chair of the Audit Committee and to the Auditor.

THE EXTERNAL AUDITOR

The role of the external Auditor is to provide an independent opinion of a set of financial statements in order to show whether these give a true and fair value of the company. There should be regular turnover in use of an external Auditor to ensure that they remain impartial and are able to exercise professional scepticism.

RISK AND INTERNAL CONTROL

Risk management must be a prominent consideration at any company. In addition to an external audit, an effective, robust and well-resourced internal audit has a central role to play in supporting boards to better manage and mitigate the risks the company faces. Firms should focus on risk in the context of the business strategy, the firm's size and global footprint, as well as its assets, liabilities and the wider political and regulatory environment.

It is the internal Auditor's task to provide an annual internal opinion on the state of the organisation's arrangements in relation to risk management, governance and internal control. This function may also include an advisory or consultancy function, where they support management in improving systems and controls.

Cybersecurity

The move to home working during and after Covid-19, alongside the current geopolitical situation, has increased cybersecurity risks. These risks can arise not only from the technology itself but also from the people using it and the processes supporting it. It includes risks to information (data security) as well as assets, and both internal risks (for example, from staff) and external risks (such as hacking). Investors need to ensure that companies are managing these threats appropriately, by having governance and oversight structures in place and reporting on potential breaches and solutions.

Investors should encourage companies to explicitly disclose the governance and oversight structures in place to identify and manage these risks, as well as provide timely reporting of any breaches and the measures taken in response.

Cybersecurity should also be an active consideration when selecting a supplier and suitable provisions should be included in contracts. Investors should agree what metrics to use to monitor their suppliers, at a depth and frequency proportionate to their risk.

Artificial Intelligence (AI)

Artificial Intelligence (AI) is likely to be one of the biggest technological leaps in history. It is poised to unlock new business models, transform industries, reshape people's jobs, and boost economic productivity.

AI has the potential to change the investment landscape in three ways:

- Investors will place more value on the quality of a company's AI assets and capabilities.
- Investors themselves will rely far more on AI-based research techniques to support their investment approach.
- Investors will compete head-to-head with the technology sector for AI talent.

Although AI has the potential to generate significant opportunities, it can also generate risks for businesses, including the amplification of discrimination, proliferation of misinformation and privacy violations – particularly in relation to generative technologies.

In addition, AI is likely to be highly disruptive in the employment space, being poised to take jobs away from workers worldwide in the future. Indeed, some large technology companies are already starting to feel the heat from ESG-focused shareholders concerned about job losses due to AI, as well as the potential introduction of discrimination in employment decisions.

Investors should ensure that companies are accountable for their social impacts by aligning with evolving industry good practice. It may be that AI and AI-enabled technologies will be subject to new standards and requirements in the future in order to promote safety, security and equity. Investors will need to ensure that companies are adhering to these standards and requirements.

EVIDENCE BASE

- The key source of information provided by the Auditor is the Audit Report. Investors should pay attention to the following information:
- Evidence of professional scepticism by the Auditor
- The critical accounting policies and principles used
- The level of materiality adopted
- Assumptions and judgements
- The findings of any review undertaken by the FRC's Audit Quality Review Team (and actions taken by the board in response to the findings).

Few investors are experts on audit assumptions and methodologies and there is an ongoing policy debate regarding to what extent investors can expect to be. The key determinant of a high-quality audit is professional scepticism and a willingness to challenge management.

Investors should be prepared to dig deeper and ask questions, including disclosure on areas where the Auditor challenged management and the outcome, or even simply making a request that the Auditor be present at the AGM to answer any questions and present their Report.

On ESG metrics, it is desirable that the sustainability metrics provided by companies be assured.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

Audit

- The audited accounts represent a "true and fair" view of the state of affairs of the business. This should include its assets, liabilities, financial position and profit or loss – all of which should be prudently assessed to avoid overstating capital.
- The Audit Committee obtains a high-quality audit in the interests of shareholders, allowing for proper accountability between the audit company and the investors. This Committee has arguably the most complex brief of any of the board Committees, as objective and prudent accounts sit at the heart of an effective accountability regime.
- The Audit Committee demonstrates sufficient independence from company management. The Committee should be staffed solely by independent Directors (both from the executive, but also taking into account independence from the external Auditor) and enjoy sufficient relevant experience to carry out its responsibilities to a high standard.
- The Audit Committee Report provides 'colour' and detail. This should not simply mirror the Auditor's Report. It should include the right quality and amount of information to give investors an insight into the audit process, including:
    - Explicit details of the criteria used for Auditor selection and evaluation, including any contractual obligations to appoint audit firms.
    - Details of the audit tender process, including when the audit was last tendered and how the company ensures independence is safeguarded.
    - How the Audit Committee satisfied itself that it got the highest quality audit possible.
    - Any changes to the process and plan of the audit (and reasons for these changes), including any changes to the audit partner and the process carried out by the Audit Committee to agree this appointment.
- The audit tendering process is in line with Regulations[31] and has been rigorous. Any tendering process should enable the Audit Committee to compare the quality and effectiveness of the services provided by the incumbent audit with other audit firms –

[31] The Statutory Auditors and Third Country Auditors Regulations 2016, The Stationary Office <The Statutory Auditors and Third Country Auditors Regulations 2016 (legislation.gov.uk)>.

including those outside the Big Four. The intention to tender the audit contract should be disclosed in advance within the Report and Accounts and the process should focus on audit quality – not costs – including the Auditors' independence and processes to ensure professional scepticism.

- The Audit Committee fully discloses any members' connections with the current or potential Auditor. Committee members should also have recent and relevant financial experience related to audit, accountancy or investor practitioner expertise.
- Additional disclosures clearly cover any the reasons for any Auditor resignation and fully detail all non-audit fees and policy on non-audit work. Where the Auditors supply non-audit services to the company, the Audit Committee should keep the nature and extent of such services under regular and closer review, to ensure objectivity is not compromised. Disclosure of non-audit fees should include:
    - Clear breakdown between the types of services received
    - Tax compliance services are differentiated from tax advisory services
    - Non-statutory acquisition-related services are separated from statutory services.
- Appropriate use is made of third parties for non-audit services (including outside the Big Four). Where the company also uses its Auditors for non-audit work, the rationale must be clearly explained. No more than 50% of the audit fee should be spent on non-audit services.
- The AGM includes a presentation from the Auditor. This happens increasingly rarely, but the PLSA would be keen for this to take place more frequently. Such appearance would give investors the opportunity to directly ask questions and hopefully raise the profile of audit issues.
- Company is looking to apply on a voluntary basis the FRC's Audit Committees and External Audit: Minimum Standard.

Risk and Internal Control

- The Annual Report covers the key elements of the business. It should explain how the company generates value from its key tangible and intangible assets. It should set out the how the board establishes and maintains an effective risk management and internal control framework – including ESG and reputational risks.
- The Annual Report covers emerging risks, demonstrating a dynamic approach to risk assessment. This could include risks from climate and cybersecurity, or tax management (and the potential impact on reputation and brand value). Companies should be communicating what changes have occurred in relation to their risks over the previous year, how it has chosen to respond and the impact so far – including likely impact on the overall business strategy and model.
- Directors state whether they expect the company to meet its liabilities as they fall due over the period of their assessment. This should include drawing attention to any qualifications or assumptions as necessary. This should be as part of an articulation as to whether they

have a reasonable expectation that the company will remain a viable and sustainable enterprise for the foreseeable future.
- Directors articulate their reasons for choosing a specific timeframe. This should follow the FRC's guidance that the length of the period should take account of the board's stewardship responsibilities, previous statements they have made, especially in raising capital, the nature of the business and its stage of development.

Cybersecurity and AI

- Companies have identified their cybersecurity vulnerabilities and have policies in place in case of a cyber-attack.
- Companies have a cybersecurity training policy in place for employees and have adopted best practices to enhance network and device security.
- Companies have implemented robust data anonymization techniques when using AI, which allows businesses to protect data privacy.
- Companies take a zero-trust approach when selecting AI tools and third-party services, by vetting them against corporate privacy and security policies, to ensure the business is not being exposed to risk and vulnerabilities.
- Companies monitor their use of AI and have a governance framework for an acceptable use of AI.

HOW INVESTORS SHOULD CONSIDER VOTING

Investors should note that in most cases, but not always, there are separate resolutions which cover the appointment of external Auditors and the setting or authorisation of the board to set Auditors' fees. This is important because investors may have concerns about the balance between audit and non-audit fees, which need to be considered separately to the appointment of the Auditor alone.

There is a range of resolutions that investors might use as a vehicle to express concerns regarding audit process or outcomes. These include: the vote to appoint or reappoint the Auditor; the vote to give Director's power to agree the Auditor's fee; the vote to approve the Report and Accounts; or the election of the Chair (or other members) of the Audit Committee.

Investors should consider voting against the Annual Report and Accounts and perhaps also the Auditor and/or Audit Committee Chair if there are ongoing concerns in relation to:

- The audited accounts fail to provide a true and fair view of profit or loss, assets or liabilities (for example, they overstate profit or assets or understate likely liabilities such as pension or climate-related liabilities). Please note: if the Auditor is seen to have helped reveal this issue, then their re-election, all other things being equal, should be strongly supported.
- There is ongoing use of alternative performance measures to report on business performance and their use is not transparent and fully justified, or where the reconciliation

to the generally accepted accounting principles accounting numbers if unclear, or where the calculations change regularly in ways that appear to flatter management delivery.
- There is poor disclosure of the strategy and risk exposures or a lack of disclosed review of the company's risk management and internal control systems.
- There is either no viability statement which looks out over multiple years, or one which does not evidently consider a full range of risk factors.
- The climate change assumptions that underlie calculations of relevant and publicly stated asset valuations or business profits are not sufficiently transparent or appear to be inconsistent with science and expert opinions on climate change.
- The company's disclosure on cybersecurity risk – and on steps to mitigate this risk – is particularly poor.

Investors should consider voting against the re-election of the Chair of the Audit Committee and reappointment of the Auditor if:

- The tenure of an external Auditor extends beyond ten years and there has not been a recent tender process and where no plans to put the audit service out to tender are disclosed.
- The Auditor has been in place for more than 20 years.
- The non-audit fees exceed 50% of the audit fees in consecutive years without an adequate explanation being provided.
- There are major concerns regarding the audit process and quality of accounts – particularly a failure to provide a true and fair view (or good visibility over the payment of dividends) and these are not resolved satisfactorily by the board.
- Cybersecurity risks (or any breach responses) are not being sufficiently well managed.

Investors should consider voting against authorisation of Auditors' remuneration (or the reappointment of the Auditor if these resolutions are bundled) if:

- The Auditor's Report fails to address a key issue or is otherwise unsatisfactory.
- Audit fees have been either increased or reduced by a significant proportion (e.g. more than 20%) in a given year without a clear justification.

Investors should consider voting against the re-election of the Chair if:

- There are extreme concerns or persistently poor disclosure in regards to the sufficient auditing of the company.

Investors should consider voting against the re-election of a Director (including re-election of the Chair) if:

- There is evidence of egregious conduct attributable to a particular Director around the development and deployment of AI.

SECTION 5: REMUNERATION

The UK is still in the depths of a severe cost-of-living in crisis, which is likely to be impacting the vast majority of those employed in investee companies as well as pension scheme savers.

This is an area of particular focus amongst investors, especially after the introduction of new disclosure requirements by the Companies (Miscellaneous Reporting) Regulations 2018.[32] The legislation established mandatory reporting for some companies on employee and stakeholder engagement, and disclosure of information on the ratios between CEO and average staff pay, among other demands.

According to Minerva Analytics, in the 2023 voting season, 143 companies put forward remuneration policy votes, of which 18 received high dissent, a fall from the 20 of 111 resolutions in 2022. In 2023, 44 remuneration report approvals received high dissent, an identical number to 2022.[33]

Executive Pay

The PLSA has always recognised the importance of appropriate remuneration policies as a litmus test for wider corporate governance practices. We are particularly concerned at some of the executive awards being made, which have historically been significantly out of step with those made to the wider workforce. This was especially concerning in 2023, with inflation only dropping below 5% in October[34], resulting in financial difficulties for many UK households, including in accessing electricity and gas. The PLSA also believes there is limited evidence that the increase in executive pay over the years has genuinely been in response to performance.

While there is limited data on shareholder dissent on this issue, it remains the case that 'Say on Pay' votes are advisory only. The say on pay legislation was introduced in 2002 and requires publicly traded firms to submit an executive Remuneration Report to a non-binding shareholder vote. According to research from Harvard Business School, there has been no evidence of a change in the level and growth rate of CEO pay after the adoption of the new rules.[35] A second stage in the evolution of the regime began in 2013, when shareholders were granted a binding vote on remuneration policy. Another study stated that in light of the continuing presence of significant levels of excess pay, say on pay has to date had limited success as a regulatory strategy.[36]

[32] The Companies (Miscellaneous Reporting) Regulations 2018, The Stationary Office <https://www.legislation.gov.uk/uksi/2018/860/contents/made>.

[33] Minerva Analytics, 'Minerva Briefing 2023 Proxy Season Review' Minerva Analytics (2023).

[34] Office for National Statistics 'Consumer price inflation, UK: October 2023', Office for National Statistics (2023) <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/october2023>.

[35] Fabrizio Ferri and David Maber 'Say on Pay Vote and CEO Compensation: Evidence from the UK', Harvard Business School (2007) <https://www.hbs.edu/faculty/Pages/item.aspx?num=30651>.

[36] B. Wu, Iain MacNeil, Katarzyna Chalaczkiewicz-Ladna "Say on pay' regulations and director remuneration: evidence from the UK in the past two decades', Journal of Corporate Law Studies (2020) <http://eprints.gla.ac.uk/210140/7/210140.pdf>.

The PLSA calls on companies to exercise restraint in executive pay, especially during the cost-of-living crisis. The PLSA also encourages investors to evaluate all aspects of a company's remuneration policy, with a view towards ensuring that it is closely aligned with investors' interests, driving long-term strategic success and is in line with wider workforce policies.

Investors should be aware that there is a significant and growing reputational risk from the issue of poorly managed executive remuneration, including for investors themselves and how well they are holding companies to account on this issue.

We also believe there is growing demand for alignment between remuneration and wider sustainability targets, and we now expect to see this reflected in voting policies.

Gender and Ethnicity Pay Gaps

Companies with over 250 employees are mandated to report on gender pay gap, which is normally included in a separate document alongside their Annual Report.[37] Ethnicity pay gap reporting, however, is not yet compulsory. A 2021 recommendation from the UK Government's Commission on Race and Ethnic Disparities detailed that companies that choose to publish pay gaps between ethnic groups should also publish a diagnosis and action plan to address them.[38] In December, a group of 10 major UK investors, coordinated by ShareAction, called on the FCA to introduce mandatory ethnicity pay gap reporting for financial institutions.[39] More information on the topic of diversity and inclusion can be found in Section 3: Composition, Succession, and Evaluation.

EVIDENCE BASE

There are often several pages dedicated to executive remuneration in the Annual Report. However, it is vital that companies and shareholders also have regular discussions on strategy and long-term performance; investors must be sure to then use these engagements as an opportunity to encourage firms to directly link remuneration and corporate performance objectives.

Remuneration metrics should be considered in the context of the sector in which the company operates, the wider workforce and what similar companies are doing in terms of their pay arrangements. There should be evidence of a range of long-term remuneration structures considered, with a robust, long-term business rationale as to why a particular approach – such as a Long Term Incentive Plan (LTIP) – was chosen over other approaches such as deferred stock options.

[37] Government Equalities Office, 'Who needs to report their gender pay gap' Government Equalities Office (2020) <https://www.gov.uk/guidance/who-needs-to-report-their-gender-pay-gap>.

[38] Commission on Race and Ethnic Disparities, 'Commission on Race and Ethnic Disparities: The Report' (2021) <Commission on Race and Ethnic Disparities – Commission on Race and Ethnic Disparities: The Report – March 2021 (publishing.service.gov.uk)>.

[39] ShareAction 'Investor Letter to the Financial Conduct Authority on Diversity & Inclusion', ShareAction (2023) <https://cdn2.assets-servd.host/shareaction-api/production/resources/reports/FCA-Investor-Letter-press-2023.pdf>.

Investors should also ensure that there is a discussion of the remuneration quantum and not just the approach, bearing in mind the increased scrutiny from public and policymakers regarding big pay packages in an era where we are likely to face greater economic and market uncertainty.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Remuneration structures and incentives for Executive Directors should cascade down to all employees in order to allow staff to also share in the success of the business. For example, companies should seek to offer employees share awards in the most cost effective and simple manner. This should also include Executive pension contributions – rates for Executive Directors should be in line with those available to the workforce. This should be the case for new Directors and investors should engage as much as possible to ensure that this is the case for existing Directors too.
    - Maximum pay-outs must remain in line with the expectations of shareholders and other stakeholders, including workers and the wider society.
    - The pay policy should not enable any pay award larger than what is necessary to successfully execute the company's wider strategy and to incentivise and reward appropriately.
    - There are clear time frames for bringing Executive pension contribution rates for existing Directors in line with those of the wider workforce. No compensation should be awarded for this change.
    - New Executive Directors or any Director changing role are appointed at the same level of pension contribution as for the overall workforce.
- The remuneration policy is clearly linked to incentivising behaviours which are consistent with the company's purpose and values. This should include performance on environmental and social issues and should demonstrate some recognition of wider societal expectations, the general economic environment and the returns to long-term shareholders.
    - Remuneration Committees should take into consideration (as a starting point) the company's strategic plan and KPIs to ensure there is a strong explanation for the drivers of executive remuneration given the company's overall strategy.
    - This should include a plan in the near-term, if not already undertaken, to tie remuneration to company performance on relevant and material environment and social metrics. Please note that this should be done in a way which does not incentivise the pursuit of sustainability at any cost and should be appropriate to the company context.
    - Where LTIPs are used, these should be linked to several different performance metrics, perhaps including a combination of growth, earnings and a mix of top-line and bottom-line contributions, in order to avoid incentivising short-term behaviour by executives.
- Pay schemes are clear and understandable for both investors and executives. Firms should not be operating multiple long-term schemes – a multiplicity of awards, with varying performance conditions is rarely successful in motivating company executives.

- The Remuneration Committee designs rewards that drive long-term success. Remuneration Committees should take ownership of, and be accountable for, both the remuneration policy and its outcomes. Companies should consider how they might align pay more closely with the interests and expectations of their long-term owners in order to position themselves well for future success.
- The Remuneration Committee exercises its judgement, taking a critical and challenging approach to pay increases. Shareholders allow remuneration Committees' significant discretion and room to exercise judgement about the overall performance of the company when determining awards.
    - Even when Remuneration Committees are thinking about making executive salary increases that are in line with the average employee increase, consideration should be made to how competitive pay is already and to the extent to which this will increase all other areas of remuneration (typically already much higher than that available for employees).
    - Remuneration Committees should demonstrate that they are prepared to exert downward pressure on executive pay where necessary and that they have used their discretion to ensure that awards properly reflect business performance. This should include a willingness to scale back on account of wider factors relating to the company, as well as its conduct, reputation and relationship with key stakeholders.
    - Where Remuneration Committees have used their discretion in an upwards direction, they should explain appropriately.
    - Remuneration Committees should consider how the results have been achieved, not just what was achieved including the creation of meaningful value and not just temporary stock price increases.
- Executive management makes a material long-term investment in shares of the businesses they manage. Senior Executives should have significant "skin in the game" of the companies they manage. Importantly, this should not just arise owing to share awards, but be as a result of active purchase of shares by Executives in the open market.
    - The bulk of variable rewards should flow over time from the benefits of being an equity owner.
    - Companies should also consider ensuring that Executives are exposed to some tail risk for an appropriate length of time once they leave a company.
- There is a cap on variable pay and clear Remuneration Committee consideration of the overall quantum. There is no need for there to be a cap on fixed pay, but Remuneration Committees should ensure there are set limits for variable pay (typically as a percentage of salary). They should also consider whether an overall pay cap (i.e. the value of awards actually paid) may be appropriate in certain circumstances to ensure executives are not benefiting from windfall gains, particularly as a result of external factors which are outside of management's control.
- There is a clear narrative to support the gender pay gap figures. This should include a well-targeted action plan for any improvement, including anticipated outcomes and how it links back to the company's strategy. The best companies will also be disclosing – in advance of likely

future mandatory reporting requirements – their ethnicity pay gap and any supporting narrative.
- The company initiates appropriately regular discussions with investors on strategy and long-term performance. Any discussions on remuneration should be initiated at a sufficiently early stage and include long-term investors who are committed to stewardship.
- The company includes in its annual report a description of its malus (reducing bonuses before payment and clawback (recovering bonus after payment) provisions, which can be applied in certain circumstances such as payments based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure[40].

HOW INVESTORS SHOULD CONSIDER VOTING

It is important that investors note the difference between a remuneration policy and a Remuneration Report when it comes to choosing the right resolution on which to express a view. While one does impact the other, a vote for or against one does not necessarily require a vote for or against the other. Shareholders should view the separate resolutions independently.

On the Remuneration Report resolution specifically: given that this is advisory and that many companies remain too slow to heed the message on remuneration, the PLSA believes it is more appropriate for investors to vote against any Remuneration Report that they feel unable to support, rather than abstain.

<u>Investors should consider voting against the remuneration policy</u> if:

- The company's remuneration policy fails to meet the standards outlined above.
- Pay policies may result in pay awards that could bring the company into public disrepute or foster internal resentment.
- The pay policy awards 'sign-on' bonuses without the inclusion of any conditionality, or allows for the payment of awards not already vested at the previous employer.
- The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support. This represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role.
- There is no provision to enable the company to claw back sums paid or scale back unvested awards. Such provisions should not be restricted solely to material misstatements of the financial statements.
- The pension payments or payments in lieu of pension (as a percentage of salary) for new appointments are not in line with the proportion paid to the rest of the workforce.
- There is no plan to bring pension payments to incumbent Directors in line with the proportion paid to the rest of the workforce over the next few years.
- There is an excessive amount of flexibility being provided for 'exceptional circumstances'.

[40] Financial Reporting Council 'Corporate Governance Code Guidance', Financial Reporting Council (2024) <https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/corporate-governance-code-guidance/>.

- The recruitment policy is vague and unlimited or substantial headroom is given and not accompanied by substantial additional hurdles.
- There are guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments.
- There is any re-testing of performance conditions to enable awards to be made.
- New share award schemes are layered on top of existing schemes.

Investors should consider voting against the Remuneration Report if:

- There is insufficient evidence of alignment with shareholders' interests and company long-term strategy. This could include, but is not limited to, a shareholding requirement for which the level is set at less than 2x salary.
- The metrics used are inappropriate or there are insufficiently stretching targets for annual bonus or LTIP.
- There are annual pay increases in excess of those awarded to the rest of the workforce and an absence of a convincing rationale.
- Pension payments to incumbent Directors (as a percentage of salary) are higher than the rest of the workforce and there is no evidence that this will be reduced.
- The pension payments, or payments in lieu of pension (as a percentage of salary) for new appointments, are not in line with the proportion paid to the rest of the workforce.
- There is a failure to disclose (or to have a retrospective disclosure of) variable pay performance conditions for annual bonuses or ex-gratia and other non-contractual payments.
- There is a change in control provisions which trigger earlier and/or larger payments and rewards and there is an absence of service contracts for executive Directors.
- The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role.

Investors should consider voting against the Remuneration Committee Chair (Director's election) if they have been in post for more than one year and:

- The company has repeatedly failed to take investors' concerns into account and fail to respond in what investors consider to be an appropriate fashion.
- The process of engagement pre-AGM has failed to result in a remuneration policy that shareholders can support, or shareholders feel that the Chair has failed to take on board their concerns about the Remuneration Report.
- Any revised policy continues, on a repeat basis, to fail to meet the principles outlined above.

SECTION 6: CLIMATE CHANGE AND SUSTAINABILITY

Though the cost-of-living crisis has grabbed the headlines in 2023, there is no evidence that investors are reducing their focus on climate change issues. Indeed, the PLSA has noted an increased focus among its members to hold their investment chains accountable to their Net Zero commitments, with a growing expectation of targets and transitions plans. According to a PLSA survey from Q4 2023, more than two-thirds of pension funds have a commitment to net zero alignment in place (68%), up from just over half (57%) in May 2022.[41]

The PLSA believes that climate change – or, rather, the climate emergency – is a systemic issue affecting nearly every industry and nearly every firm. Although the risks and opportunities arising as a result of climate change will impact some sectors more than others, most companies will need to assess the impact of climate change on their strategy and business model in the coming years if they are not already doing so.

The pension sector is now required to produce an annual TCFD report,[42] including all schemes with over a £1 billion AUM. LGPS funds will fall into the scope of new legislation to comply with TCFD reporting, after a consultation was published in 2022. However, at the time of publication of this document, the industry is still waiting to hear a final decision from the Department for Levelling Up, Housing and Communities (DLUHC). The PLSA therefore expects that companies reference the TCFD in their reports, in order to enable investors to fully assess the extent of their climate risk. We also expect to see evidence of credible transition plans, given the likelihood that this will soon be a mandatory requirement.

Companies should also disclose relevant material business issues and their strategic approach to addressing these, for instance their role in public policy and advocacy on related issues, as well as their membership within trade associations conducting similar activities.

While the issue of climate change is currently receiving significant focus, other sustainability issues – such as waste, deforestation, water usage/scarcity and biodiversity – are also high on many investors' agendas. Investors should be careful not to ignore non-climate sustainability issues and consider carefully which sustainability issues are most material to holdings in their portfolio, prioritising allocation of stewardship resources appropriately.

According to Minerva Analytics, in the 2023 proxy voting season, results for ESG-focused resolutions were mixed with more shareholder proposals but lower support, and regional variations. This reflected regional circumstances such as filing rules and anti-ESG sentiment.

[41] Pensions and Lifetime Savings Association 'Number of Pension Funds with Net Zero commitment continues to rise', Pensions and Lifetime Savings Association (2023) <https://www.plsa.co.uk/press-centre/news/article/number-of-pension-funds-with-net-zero-commitment-continues-to-rise>.

[42] Taskforce for Climate-Related Financial Disclosures 'Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures' Taskforce for Climate-Related Financial Disclosures (2017) <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.

However, shareholders are considering a wider range of issues when voting on director elections and factoring in ESG oversight in voting decisions.[43]

Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework, approach and timescales. Nevertheless, their focus on climate reporting should remain the expectation.

BIODIVERSITY

The World Wildlife Fund (WWF) defines biodiversity as the "...variety of animals, plants, fungi, and even microorganisms like bacteria that make up our natural world. Each of these species and organisms work together in ecosystems, like an intricate web, to maintain balance and support life."[44]

The accelerating loss of global biodiversity is driven by several factors, including global warming from climate change, industrial activities (such as deforestation or water usage) and farming to fuel high consumption demands worldwide. These contribute to habitat destruction through the extensive transformations in how land and oceans are being used. Transport for trade and tourism are also drivers of the spread of invasive alien species which threaten ecosystems. International trade and habitat destruction have also been identified as factors in the spread of disease that threatens both humans and wildlife.[45]

These changes in the natural world have direct impact on financial markets, supply chains and corporate profitability, with knock-on impact on pension scheme investments tied to sectors linked to biodiversity loss. As a result, pension schemes will need to begin to treat biodiversity with the same prominence given to climate change. This can mean including biodiversity and natural capital impacts in assessments of a company's transition plans. Schemes can also consider voting to support resolutions that seek to encourage companies to address direct or underlying drivers of biodiversity loss. Votes against directors can also be considered, where efforts to address drivers of biodiversity loss are deemed insufficient.[46]

Schemes can also encourage investee companies in at-risk sectors to engage with the Taskforce on Nature-related Financial Disclosures (TNFD) on approaches to better integrate impact on nature into decision-making, as well as on approaches to identify and access biodiversity data.[47] Working closely with asset managers will also be important to understand their biodiversity-related risk

[43] Minerva Analytics 'Minerva Briefing 2023 Proxy Season Review'. Minerva Analytics (2023).
[44] WWF 'What is biodiversity? Why it's under threat and why it matters' WWF<https://www.worldwildlife.org/pages/what-is-biodiversity>.
[45] LSE, Grantham Research Institute on Climate Change and the Environment 'What are the extend and causes of biodiversity loss?' LSE, Grantham Research Institute on Climate Change and the Environment(2022) <https://www.lse.ac.uk/granthaminstitute/explainers/what-are-the-extent-and-causes-of-biodiversity-loss/>.
[46] Railpen 'Global Voting Policy 2024', Railpen (2023) <https://cdn-suk-railpencom-live-001.azureedge.net/media/media/3dsbs2tm/voting-policy-2024.pdf>.
[47] Ibid.

assessments, as well as their engagement strategies with invested companies, and capital allocation to nature-positive initiatives.[48]

CLIMATE CHANGE RESOLUTIONS: WHAT SHOULD INVESTORS LOOK FOR?

The last few years have seen a growth in the number of climate-related resolutions being tabled at AGMs. We are also now seeing 'Say on Climate' and other shareholder initiatives resolutions tabled by companies, mainly seeking approval for the climate action plans.

Launched by the hedge fund activist investor Chris Hohn through the Children's Investment Fund Foundation, 'Say on Climate'[49] is a campaign promoting shareholder voting on climate transition action plans. The initiative was deemed the biggest shake-up of the annual meeting season since the US and UK gave shareholders a vote on executive pay[50]. However, the campaign has been more popular in Europe, Australia and Canada, while the US is yet to see its first 'Say on Climate' vote.[51]

If an investor judges that climate risk is particularly material to a holding in their portfolio, then they should strongly consider supporting resolutions tabled by others (or tabling a resolution themselves if they have sufficient resources) where this is in the broader shareholder interest.

Questions which investors should be asking when deciding whether to support a given resolution include:

- Does it conflict with other climate resolutions? If so, which one will be most effective in achieving aims in line with the impact on the portfolio?
- Has it been supported by management?
- Does it focus on disclosure of activities and action (i.e. taking a behavioural approach which is trying to nudge companies into certain behaviours) or on the substance?
- If the resolution covers issues applicable across a sector, have similar requests been made of other companies in the industry or is there a justifiable reason why the company has been singled out for attention?
- Does it clearly link to internationally agreed upon targets and other agreements such as the Paris Agreement?
- Is the resolution binding? If so, is the request proportionate? Is there a good understanding of its likely impact on all relevant stakeholders if passed? Would it impact the ability of the company to make strategic decisions without seeking further shareholder approval in the future? Or does it offer some flexibility?

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[48] Burgess Salmon 'ESG: Biodiversity and nature risks for pension schemes', Burges Salmon (2023) <https://blog.burges-salmon.com/post/102iq7g/esg-biodiversity-and-nature-risks-for-pension-schemes>.
[49] https://sayonclimate.org/
[50] Attracta Mooney, Billy Nauman "Say on Climate' campaign faces first big test at investor meetings', Financial Times (2021) <https://www.ft.com/content/cc409667-e048-4246-808c-9cdf8e41ac77>.
[51] BNP Paribas Asset Management 'The Unpredictable Future Of Say-On-Climate Votes', BNP Paribas Asset Management (2023) <https://docfinder.bnpparibas-am.com/api/files/3C84684E-93F2-42B6-BE7A-42565C1E0EEF>.

- If the resolution is non-binding (sometimes known as “precatory”), is the aspiration appropriate and consistent with the business’ long-term success? What actions would be appropriate for the company to take in response to the resolution? If those actions were not taken, how concerned would the investor be?
- Would voting against resolutions on political donations, re-election of the responsible Director or the Annual Report and Accounts better reflect specific concerns on a particular area (i.e. lobbying)?
- For Say on Climate and other shareholder voting resolutions, are the plans put forward for approval underpinned by credible targets? (Ideally plans should reflect an established industry frameworks and be in keeping with the UK TPT guidance[52]).

EVIDENCE BASE

The PLSA believes that pension schemes should have access to as much information as possible – (including metrics and climate scenario testing) to enable them to invest well. It is mandatory for listed companies to measure and report on the greenhouse gas emissions that they are responsible for producing. However, although this information is vital, it is not sufficient in itself. This should therefore be accompanied by a clear narrative surrounding the approach that the company is taking to ensure it manages this risk through its governance, processes and internal control arrangements.

Investors may prefer that companies take a joined-up, industry wide approach to climate change and other sustainability issues, both environmental and social. Due to the interrelated nature of climate change impacts, system-wide approaches and discussions (rather than single-issue responses) may yield more insights.

Given the systemic nature of the risk the climate emergency poses to companies, there could also be implications for capital structure and allocation. Investors should also carefully scrutinise disclosures regarding any planned capital expenditure on climate change related research and development, or whether any relevant merger and acquisition activity has been planned.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Climate change is discussed in terms of strategic, financial and operational factors. The potential impact of different scenarios, such as the reactions of policymakers and regulators on value creation in the long-term, should be clearly discussed. There should also be a clear link to risk management at the executive level and risk oversight at the board level. The impact of climate risk and opportunities of the firm’s strategy over the short-, medium- and long-term should be clearly outlined.

[52] Transition Plan Taskforce ‘Consultation The Transition Plan Taskforce Implementation Guidance’, Transition Plan Taskforce (2022) <https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Implementation-Guidance-1.pdf>.

- There are clear climate-related governance and oversight structures and processes. This includes climate change expertise at the board level, identification of which Director is accountable for climate issues and management's role in assessing and managing climate-related risks and opportunities. Every Director should demonstrate an understanding and awareness of the potential range of impacts which climate change may have on the company.
- A proactive approach both to identifying and managing climate risks and opportunities and sufficient disclosures on climate change. Companies should be referencing the TCFD framework in disclosures. There should be clear evidence that companies are considering the issue of climate change across the high-level TCFD areas of governance, risk management, strategy, metrics and targets and scenario analysis.
- The potential consequences of the expected physical impacts of climate change are actively considered and discussed in reporting. The resilience of assets and supply chains in the face of, for example, changing weather patterns and rising sea levels, should be considered as relevant.
- Companies also need to demonstrate their consideration of the potential impact of changes in public policy and regulation around the transition to a low carbon economy. The narrative reporting should reflect the level of financial disclosures provided.
- Clear reference to and use of credible industry climate reporting metrics in the Annual Report and Accounts. This should include reference to the TCFD, Sustainability Accounting Standards Board (SASB),[53] Climate Disclosures Standards Board (CDSB),[54] or other established third-party frameworks. Companies should provide explanations as to the rationale for their choice of framework and the extent to which, if at all, relevant metrics have been blended with others. Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework and timescales.
- Disclosures refer to the Paris Agreement and mention the UK's Net Zero goal. Companies should disclose whether they have assessed if their business model is compatible with commitments to mitigate global temperature increases (at either 2 or 1.5 degrees) and, where they do not feel this is currently the case, have outlined a process (complete with relevant timescales) under which they hope to achieve compatibility.
    - This should include a discussion of the metrics which the company has chosen to assess climate-related risks and opportunities in line with its strategy and risk management. These metrics should include Scope 1, 2 and (where relevant) Scope 3 greenhouse gas (GHG) emissions.[55]

[53] Sustainability Accounting Standards Board 'SABS Standards', Sustainability Accounting Standards Board <Download SASB Standards - SASB>.
[54] Climate Disclosure Standards Board 'CDSB Framework for reporting environmental & social information', Climate Disclosure Standards Board (2022) <cdsb-framework-2022.pdf (ifrs.org)>.
[55] Greenhouse Gas Protocol <Greenhouse Gas Protocol | (ghgprotocol.org)>.

- Credible transition plans set out clear interim targets and milestones, material actions, activities and accountability mechanisms.
- Financial disclosures include transparency on the underlying assumptions used to calculate balance sheet valuations and earnings. Many key valuation and profit measures disclosed by companies depend on assumptions about future returns. Investors may wish to challenge the calculations and/or substitute alternative assumptions in their own financial analysis, should there be concern that these may be dependent on the Paris Agreement not being delivered in practice. In order to be open to such discussion, companies should be transparent on the assumptions underlying their calculations.
- A company's political donations and its trade associations membership are aligned with their stance on climate change. Investors have become increasingly concerned about corporate support for organisations and individuals whose lobbying activities and objectives are considered to frustrate climate change mitigation. Such support may take the form of political donations, trade association membership or the establishment of charitable or educational trusts that undertake lobbying against progressive climate legislation.
- The company has produced a summary of biodiversity impacts caused by its activities in its corporate scope of biodiversity influence, and has a list of goals and objectives that can be focused, and against which company biodiversity performance can be measured.
- The company has developed strategic and monitoring plans describing indicators to be used and mapping out how data will be collected, when, how, where and by whom.
- The company has, or plans to create, a database of relevant data on indicators, and a monitoring and reporting systems which ensure data is provided in a standardised format that can be displayed in appropriate data products, such as maps and dashboards, to meet decision-makers' needs at each level of the company.[56]

HOW INVESTORS SHOULD CONSIDER VOTING

Investors should consider voting against the Annual Report and Accounts if:

- There is insufficient disclosure on how a company intends to monitor and manage the risks and opportunities brought about by climate change.
- The business has operations which are highly carbon intensive and there has been no disclosure of the climate-related assumptions which underlie their financial calculations, or where those assumptions are not consistent with the Paris Agreement.

[56] International Union for Conservation of Nature 'Guidelines for planning and monitoring corporate biodiversity performance', International Union for Conservation of Nature (2021) <https://portals.iucn.org/library/sites/library/files/documents/2021-009-En.pdf>.

- The business has operations which are highly carbon intensive and there is no commitment to disclose memberships and involvement in trade associations that engage on climate-related issues.

Investors should consider voting against the remuneration policy if:

- There are no plans to align senior Executive remuneration to performance against relevant sustainability metrics within a reasonable timeframe.
- The business has operations which are highly carbon intensive and has not included at least one climate-related metric in the calculation of executive incentives. The metrics also should not be contradictory.

Investors should consider voting against the re-election of the Director or the re-election of the Chair if:

- Shareholders have attempted to engage on the issue and companies have still failed to demonstrate effective board ownership, for example providing a detailed risk assessment and response to the effect of climate change on the business, or incorporating appropriate expertise on the board.
- The business is not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDSB, SASB or another established third party framework. For smaller businesses, they are not readying themselves at a pace proportional to the resources available and the TCFD roadmap.
- The business has operations which are highly carbon intensive and has not made sufficient progress in providing the market with investment relevant climate disclosures including committing to publish science-based targets.
- The company has not listened to investor concerns about any direct or indirect corporate lobbying activity whose objectives are considered to frustrate climate change mitigation.
- The company has not responded appropriately to the result of a climate change related resolution, whether binding or not, and whether it was passed or not.
- The company efforts to mitigate agricultural commodity-driven deforestation are considered insufficient.

Investors should consider voting in favour of relevant climate-related or similar resolutions – including Say on Climate resolutions – by making assessments on a case-by-case basis.

SECTION 7. SOCIAL FACTORS AND WORKFORCE

Since the advent of ESG, climate change has been at the forefront of investors' minds, since it poses far-reaching global financial risks. Over the years, social factor concerns have lagged for a variety of reasons, from issues with its definitions to difficulties in quantifying social risks and opportunities for the portfolio.

However, recent global events - such as the Covid-19 pandemic pushing millions of people globally into extreme poverty,[57] the 2022 Russian invasion of the Ukraine and the 2023 Israel/Gaza conflict, several protest movements, such as Black Lives Matter or the movement towards Iranian women rights, and the treatment of the Uyghur people in China - have helped to create context and a momentum for engagement with social topics that may have links to pension fund investments.

Despite social factors being wide-ranging, the industry has agreed these can manifest at the company level and can also represent systemic risks. According to the DWP call for evidence on 'consideration of social risks and opportunities by occupational pension schemes',[58] published in 2021, there are several lenses through which it is useful to view social factors: practices within a company, practices within a company's supply chain, company products and selling practices, and a company's impact on the community.

A study by Deutsche Bank Wealth Management conducted in 2019[59] showed that companies that take into consideration social factors are able to reduce systematic risk, idiosyncratic risk and total firm risk, and that in fact only the S in ESG is able to lower systematic risk.

Social factors include a wide range of topics from health and safety in supply chains, modern slavery, product quality and safety, customer privacy and data security, community engagement and impact on local businesses, to name a few.

A sign of the increasing Government prioritisation of this topic was the creation of the Taskforce on Social Factors for UK Pensions Industry,[60] supported by DWP and launched in 2023. The group, composed by industry experts, has three objectives:

- Identify reliable data sources and other resources, which could be used by pension schemes to identify, assess and manage financially material social risks and opportunities.

[57] Norbert Schady, Alaka Holla, Shwetlena Sabarwal, Joana Silva and Andres Yi Chang 'Collapse & Recovery: How COVID-19 Eroded Human Capital and What to Do About It', World Bank Group (2023) <https://openknowledge.worldbank.org/server/api/core/bitstreams/6fb17cf5-1fad-4147-b7bb-691f63c29541/content>.

[58] Department for Work and Pensions 'Consideration of social risks and opportunities by occupational pension schemes', Department for Work and Pensions (2021) <https://assets.publishing.service.gov.uk/media/6059fc5ce90e0724cfff4492/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes.pdf>.

[59] Professor Alfonso Del Giudice 'Guest contribution by Professor Del Giudice: Social criteria can reduce risk – with clear corporate and investor benefits', Deutche Bank Wealth Management (2019) <https://www.deutschewealth.com/content/dam/deutschewealth/cio-perspectives/cio-special-assets/s-in-esg/CIO%20Special%20-%20The%20S%20in%20ESG.pdf>.

[60] Taskforce on Social Factors 'Launch of Taskforce on Social Factors for UK Pensions Industry', Taskforce on Social Factors (2023) <https://www.taskforceonsocialfactors.co.uk/siteassets/shared-media/images/270223_taskforce_on_social_factors_luanch_feb_23.pdf>.

- Monitor and report on developments relating to the International Sustainability Standards Board (ISSB) and other international standards.
- Develop thinking around how trustees can identify, assess and manage the financial risks posed by modern slavery and supply chain issues.

In the Taskforce's guide on Considering Social Factors in Pension Scheme Investments,[61] published in October 2023 - which was open to industry consultation until 1 December 2023 - the taskforce stated that achieving an orderly and just transition to net zero requires extensive stakeholder engagement, including on issues such as low pay, poor health, and social inequalities that leave individuals and communities more vulnerable to climate change and other social shocks.

The guide also provides a framework for pension schemes to address social factors in their portfolios, considering that a coherent approach to addressing social factors in pension schemes can help manage portfolio risk and broader systemic risks.

This framework is divided in three levels – baseline practice, good practice and leading practice. Among the recommendations, the Taskforce stated that trustees demonstrating good practice should carry out a materiality assessment of the scheme's key risks and opportunities for social factors, regarding the type of investment via asset classes and geographies.

Following this analysis, trustees should prioritise the most relevant social factors and highlight these as stewardship policy priorities, while integrating these into voting guidelines and sharing them with managers as Expression of Wish (or execute their own proxy voting).[62]

According to Minerva Analytics,[63] shareholder proposals in the social space in the 2023 proxy voting season were mostly related to human rights and workforce issues, as the themes of shareholder initiatives tend to follow actual trends in society. For example, proposals requesting racial equity audits were first filed in 2021 following coverage of racial injustices in the United States in 2020. In 2023, there has been an increase in the number of proposals filed on labour issues, including the freedom of association and company compliance with the United Nations Guiding Principles on Business and Human Rights, as workers' living wages are impacted by inflation, and separately, on reproductive rights linked to the US workplace after the overturn of Roe v Wade.

WORKFORCE

A company's workforce is one of the main contributors to its long-term success, with clear and significant reporting being in the best interest of organisations. Investors will value the disclosure

[61] Taskforce on Social Factors 'Considering Social Factors in Pension Scheme Investments: Guide from the Taskforce on Social Factors', Taskforce on Social Factors (2023) <https://www.taskforceonsocialfactors.co.uk/siteassets/shared-media/images/uk_social_factors_consultation_v4.pdf>.
[62] Ibid.
[63] Minerva Analytics, 'Minerva Briefing 2023 Proxy Season Review' Minerva Analytics (2023).

of this information, especially when companies recognise the risk poor employment practices can pose and include people matters as a key element of their strategy.

As pension schemes turn their attention to the "S" and "G" of ESG, workforce issues are at the forefront of social factors stewardship policies. Asset owners are rightfully engaging with investee companies in relation to occupational health and wellbeing – with mental health becoming an even hotter topic after the Covid-19 pandemic – alongside checking on improvements in their inclusion and diversity policies, while also not forgetting issues surrounding human rights.

WELLBEING

Wellbeing at the workplace relates to all aspects of the working life, from the quality and safety of the physical environment, to how workers feel about their work and their working environment. According to the International Labour Organization, the goal of workplace wellbeing measures is to complement occupational safety and health measures and to make sure workers are safe, healthy, satisfied and engaged at work.[64]

Physical health

Under health and safety law, all workers are entitled to work in environments where risks to their health and safety are properly controlled, with employers having the primary responsibility for this.

According to the Health and Safety Executive, companies have duties under law to assess risks in the workplace, which includes identifying work activities that could cause injury or illness and taking action to eliminate the hazard, or if this is not possible, control this risk. Employers must also give information about the risks in the workplace and how staff is protected and consult with employees on health and safety issues. Companies also have a legal duty the Health and Safety Information for Employees Regulations to provide health and safety information.[65]

Recent studies from the World Health Organization and the International Labour Organization have shown a correlation between working long hours and increasing deaths from heart disease and stroke.[66] Research published in 2011 estimated that, in 2016, 398 000 people died from stroke and 347 000 from heart disease as a result of having worked at least 55 hours a week.

Recently, more attention has been paid to corporate employment practices, especially in the areas of physical health and safety, mental health and sick pay entitlements, due to the pandemic.

[64] International Labour Organization <https://www.ilo.org/safework/areasofwork/workplace-health-promotion-and-well-being/WCMS_118396/lang--en/index.htm>.

[65] Health and Safety Executive <https://www.hse.gov.uk/simple-health-safety/index.htm>.

[66] World Health Organization & International Labour Organization 'Long working hours increasing deaths from heart disease and stroke: WHO, ILO' World Health Organization & International Labour Organization (2021) >.https://www.who.int/news/item/17-05-2021-long-working-hours-increasing-deaths-from-heart-disease-and-stroke-who-ilo>.

HUMAN RIGHTS AND MODERN SLAVERY

Although modern slavery is not yet defined in international law, it is described as a crime and a violation of fundamental human rights. The UK government states it can take many forms including the trafficking of people, forced labour, servitude and slavery. It is a global problem that interlinks with age, gender and ethnicity.[67] It is not an issue confined to history or an issue that only exists in certain countries.[68]

It is estimated that 49.6 million people were living in modern slavery in 2021, of which 27.6 million were in forced labour and 22 million in forced marriage.[69] Of the 27.6 million people in forced labour, 17.3 million are exploited in the private sector; 6.3 million in forced commercial sexual exploitation, and 3.9 million in forced labour imposed by state.

There have been several initiatives from governments to prevent modern slavery. In the UK, the Modern Slavery Act 2015 contains a section which requires commercial organisations – which are a body corporate or a partnership, carry on a business, supply goods or services and have an annual turnover of £36 million or more – to develop a slavery and human trafficking statement each year. Section 54 dictates the statement is expected to set out what steps companies have taken to ensure modern slavery is not taking place in their business or supply chains.

However, an independent review of the act,[70] commissioned by the government and published in 2019, concluded although the new requirement contributed to raising awareness of these issues and has encouraged many companies to start considering and addressing it, its impact has been limited to date. Evidence gathered by the reviewers showed that a lack of enforcement and penalties, as well as confusion surrounding reporting obligations, resulted in poor-quality statements and an estimated lack of compliance from over a third of eligible firms.

In 2022, the FRC's review of corporate governance[71] found that overall, while nearly half of companies report on their policies and procedures as they relate to modern slavery, reporting fails to address the effectiveness of these measures. Furthermore, not one company in the FRC sample disclosed that it had found any cases of modern slavery in the reporting year. There were also no

[67] Genevieve LeBaron, Neil Howard, Cameron Thibos and Penelope Kyritsis 'Confronting root causes: forced labour in global supply chains', openDemocracy and Sheffield Political Economy Research Institute (SPERI), University of Sheffield (2018) <https://cdn-prod.opendemocracy.net/media/documents/Confronting_Root_Causes_Forced_Labour_In_Global_Supply_Chains.pdf>.

[68] Home Office 'Frequently Asked Questions on Modern Slavery', Home Office <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/638369/What_is_Modern_Slavery_NCA_v1.pdf>.

[69] International Labour Organization 'Global Estimates of Modern Slavery: Forced Labour and Forced Marriage', International Labour Organization (2022) <https://www.ilo.org/global/topics/forced-labour/publications/WCMS_854733/lang--en/index.htm>.

[70] Home Office 'Independent review of the Modern Slavery Act 2015: final report', Home Office (2019) <https://www.gov.uk/government/publications/independent-review-of-the-modern-slavery-act-final-report>.

[71] Financial Reporting Council 'Review of Corporate Governance Reporting', Financial Reporting Council (2022) <https://www.frc.org.uk/getattachment/6a896f6b-8f4a-4a19-8662-f87a269ffce3/Review-of-Corporate-Governance-Reporting_-2022.pdf>.

reports of finding instances of modern slavery in the businesses supply chain as a result of the modern slavery audits.

In a bid to tackle modern slavery in supply chains, the UK Government published new guidance[72] in February 2023 for commercial and procurement professionals. Although the guidance is aimed at helping Government practitioners to comply with their supply chain obligations, it is expected it will filter through to a much wider group of businesses, and is considered as an example of how the trend towards greater transparency and engagement with supply chains will affect not just those caught directly by new laws in this area.[73] The guidance focuses on four key areas: identifying and managing risks in new procurements, managing risks in existing contracts, action when victims of modern slavery are identified and training.

DIVERSITY AND INCLUSION

Workforce gender and ethnic diversity has been ranking highly in the public and political agenda in recent years, though high-profile reviews set targets for company boards rather than on an employee level.

According to the most recent FTSE Women Leaders Review (the third and successor phase of the former Hampton-Alexander & Davies Reviews), released in February 2023, progress continues to be made in certain regards on gender diversity.

On ethnicity, there has been an increased focus in this area in recent years, most notably since the widespread global protests against racism in 2020 following the death of George Floyd while in US police custody. FTSE100 companies 2021 Annual Reports included disclosures on how these organisations are investing in inclusion and diversity (I&D), mainly focusing on gender and race. Evidence of this investment was provided by 93%,[74] but only 22% of Annual Reports disclosed the workforce ethnic composition.

More information on this topic of diversity and inclusion can be found in Section 3: Composition, Succession and Evaluation, and Section 5: Remuneration discusses the gender pay gap and ethnicity pay gap.

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72 Cabinet Office ‘Update to Tackling Modern Slavery in Government Supply Chains’, Cabinet Office (2023) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1135523/PPN_02_23_-_Update_to_Tackling_Modern_Slavery_in_Government_Supply_Chains_2023_-_Guidance.pdf>.

73 Osborne Clarke ‘New guidance issued on tackling modern slavery in UK government supply chains’, Osborne Clarke (2023) <https://www.osborneclarke.com/insights/new-guidance-issued-tackling-modern-slavery-uk-government-supply-chains>.

74 Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen, ‘How Do Companies Report On Their ‘Most Important Asset’?’ Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

EVIDENCE BASE

At present, modelling the impact of social factors is difficult. This is because schemes normally use asset and liability modelling, with the process focussing on the more 'traditional' factors. Systemic issues, and many social factors in particular, do not lend themselves this type of modelling.

Currently, the 17 Sustainable Development Goals (SDGs) are the most commonly used impact performance measurement tool, with investors looking at impact to one or more of the goals, like promoting inclusive economic growth or gender equality.

Whilst it is hard to measure the impact of social factors, there is a range of data that could be standardised and compared across investment portfolios. Investors should look at investee companies' Annual Reports to gather data on number of full-time equivalent employee roles, the proportion of those who are paid a living wage, the employee turnover and the proportion of workforce on 'zero hour" contracts.[75]

While it is particularly difficult to get concrete metrics in the area of wellbeing, investors should look for progress over time and evidence that the company's approach is changing for the better.

Investors should look at Annual Reports for information about health, safety and wellbeing initiatives, alongside examples of practices to mitigate risks in this area. A useful proxy for employee mental and physical health is absence rates. High absence rates can point to unhealthy and possibly overworked staff.[76]

Companies with over 250 employees are mandated to report on gender pay gap, which is normally included in a separate document alongside their Annual Report.[77] Ethnicity pay gap reporting, however, is not yet compulsory. A recent recommendation from UK Government's Commission on Race and Ethnic Disparities detailed that companies that choose to publish pay gaps between ethnic groups should also publish a diagnosis and action plan to address them.

On human rights and modern slavery, companies should include their annually updated statement of compliance with the Modern Slavery Act, signed by a company Director and approved by the board, on the homepage of their website, which should be easily accessible. The government also has a modern slavery statement registry[78] which contains documents issued by companies.

When a company does not publish a modern slavery statement – either because they are not obliged by law to do so or because they elect to state they do not take any steps to help prevent

[75] Taskforce on Social Factors 'Considering Social Factors in Pension Scheme Investments: Guide from the Taskforce on Social Factors', Taskforce on Social Factors (2023) <https://www.taskforceonsocialfactors.co.uk/siteassets/shared-media/images/uk_social_factors_consultation_v4.pdf>.

[76] Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence 'Worthwhile Workforce Reporting: Good practice examples from the UK's biggest companies', Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Worthwhile-Workforce-Reporting-Dec-2022.pdf>.

[77] Government Equalities Office 'Gender pay gap reporting: guidance for employers', Government Equalities Office (2020) <https://www.gov.uk/guidance/who-needs-to-report-their-gender-pay-gap>.

[78] <https://modern-slavery-statement-registry.service.gov.uk/>.

slavery and human trafficking in their supply chain – further analysis should be done by investors to understand risks. This includes focusing on their jurisdiction of operations and industry sector to assess if the level of risk of there being incidences is high, medium or low.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Contributions to improving social and economic conditions in local communities where the company operates.
- Apply a social lens to markets where the company operates which allows to identify new sources of customer value.
- Investment in their current workforce, which will allow companies to develop the talent they need for the future by investing in employee learning and development.
- Enhance supply chain resilience by building socially responsible relationships with suppliers, to ensure fair and equitable practices.[79]
- Reporting through the Workforce Disclosure Initiative (WDI),[80] which allows companies to demonstrate to their investors, clients and other stakeholders that they are effectively managing their staff and supply chain workers.
- Practice ethical behaviour and social responsibility, which can be promoted through codes of conduct, transparency and accountability.
- Clear reference to and use of credible social risks mitigation measurement frameworks in the Annual Report and Accounts and/or Sustainability Report. This could include reference to the UN Global Compact – Sustainable Development Goals, Global Reporting Initiative, or other established third-party frameworks. Companies should provide explanations as to the rationale for their choice of framework and the extent to which, if at all, relevant metrics have been blended with others. Please note that smaller and medium sized companies should be allowed some discretion and flexibility regarding their choice of framework and timescales.
- Companies take into consideration social factors in all of its activities, including the products and services they offer. Businesses should ensure that their products and services do not pose safety risks, and/or minimize the exposure to geopolitical conflicts in their supply chains. Companies should also consider wider social considerations in relation to future demographic or consumer changes and how these relate to their products and services.
- Publish a clear commitment to promoting a culture of openness on mental health, with the CEO signalling leadership commitment on this area.
- Publish formal objectives aimed at improving workplace mental health. Board members and operational management should have responsibility for mental health initiatives in the company.

[79] Bain & Company 'The Visionary CEO's Guide to Sustainability', Bain & Company (2023) <bain_report_the_visionary_ceos_guide_to_sustainability.pdf>.
[80] <https://workforcedisclosureinitiative.org/>.

- Include health, safety and wellbeing matters in its risk assessment, and detail how the risk will be managed.[81]
- The company board sets objectives and targets to improve mental health and reports annually on progress against these goals.
- Publish gender and ethnicity gap reports annually, alongside initiatives to reduce these gaps.
- The board has diversity and inclusion as one of its priorities and has developed a training/awareness programme for at least the senior leadership in this area. Nevertheless, it should be taken into account there is no evidence unconscious bias training can fully eliminate implicit bias, and its ability to effectively change behaviour is limited,[82] so training programmes should be tailored to the needs of each organisation.
- The Modern Slavery Act statement, which is published on the company's website homepage, contains information about not only its policies in this area but also refers to audits and inspections conducted on sites of their suppliers.
- Company has a long-term training plan for employees and contractors on modern slavery if appropriate.
- Follow the Transparency in supply chains guide[83] issued by the Home Office and has appropriate technology to improve transparency on end-to-end supply chain management.

EMERGING AREAS OF INTEREST FOR COMPANIES

Mental health

The health and safety of employees includes mental health as well. While monitoring the physical safety of employees is a more well-established practice, mental health is a newer aspect to workforce wellbeing disclosure that is only beginning to be explored. Similarly to physical health standards, poor mental health can negatively impact corporate cultures and employee performance. The World Health Organisation has stated that poor working environments – including discrimination and inequality, excessive workloads, low job control and job insecurity –

[81] Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence 'Worthwhile Workforce Reporting: Good practice examples from the UK's biggest companies', Railpen, High Pay Centre, Chartered Institute of Personnel and Development, Pensions and Lifetime Savings Association and Board Intelligence (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Worthwhile-Workforce-Reporting-Dec-2022.pdf>.
[82] Civil Service HR 'Unconscious bias and diversity training – what the evidence says', Civil Service HR (2020) <https://www.gov.uk/government/publications/unconscious-bias-and-diversity-training-what-the-evidence-says>.
[83] Home Office 'Transparency in supply chains: a practical guide', Home Office (2015) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/649906/Transparency_in_Supply_Chains_A_Practical_Guide_2017.pdf>.

pose a risk to mental health.[84] Due to this, it makes sense for companies to provide data on wellbeing and mental health together with physical accidents and injuries.[85]

The PLSA was involved in the work of two workforce disclosure reports, which delved into the importance of mental health, with the first concluding that since the onset of the Covid-19 pandemic, mental health decline has become more widespread. Reference to employee wellbeing was made by 89% of companies in FTSE100 in 2021, with many acknowledging the negative impact of Covid-19 in employees' welfare. However, only 13% of these company's Annual Reports discussed mental health in relation to health and safety or risk assessments.[86] In the majority of cases, mental health is not being treated with the same seriousness or reporting in detail as physical health. Collecting information on mental health can be more sensitive and challenging to gather, but it is a material issue for all companies. Organisations should find ways to address and issues and sensitivities, so they are able to report on this matter.

Several research studies have shown a correlation between long-working hours and an increase in mental health deterioration. A 2008 study[87] concluded overtime workers of both genders had significantly higher anxiety and depression levels – and higher prevalence of anxiety and depressive disorders – when compared with those working regular working schedules. Another study published in 2019[88] found women's mental health is more affected than men, with increased depressive symptoms independently linked to working extra-long hours for women.

Menopause

With the number of women over 50 in employment increasing in developed countries due to higher life expectancy, menopause has become an important issue when considering workforce wellbeing. Menopause symptoms continue on average for 4 years – but can last up to 12 years – and mostly affect women between 45 and 55 years old.[89]

[84] World Health Organization 'Mental Health at Work factsheet', World Health Organization (2022) <https://www.who.int/news-room/fact-sheets/detail/mental-health-at-work>.

[85] Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen, 'How Do Companies Report On Their 'Most Important Asset'?' Pensions and Lifetime Savings Association, Chartered Institute of Personnel and Development and Railpen (2022) <https://www.plsa.co.uk/portals/0/Documents/Policy-Documents/2022/How-do-companies-report-on-their-most-important-asset-Mar-22.pdf>.

[86] Ibid

87 Elisabeth Kleppa, Bjarte Sanne, Grethe S Tell 'Working Overtime is Associated With Anxiety and Depression: The Hordaland Health Study', Journal of occupational and environmental medicine / American College of Occupational and Environmental Medicine (2008) <https://www.researchgate.net/publication/5312376_Working_Overtime_is_Associated_With_Anxiety_and_Depression_The_Hordaland_Health_Study>.

88 Gillian Weston, Afshin Zilanawala, Elizabeth Webb, Livia A Carvalho, Anne McMunn 'Long work hours, weekend working and depressive symptoms in men and women: findings from a UK population-based study', BMJ Journals (2019) <https://jech.bmj.com/content/73/5/465>.

[89] Dr Pratima Gupta in collaboration with the medical advisory council of the British Menopause Society 'The Menopause', Women's Health Concern (2022) <https://www.womens-health-concern.org/wp-content/uploads/2022/12/15-WHC-FACTSHEET-The-Menopause-NOV2022-B.pdf>.

Around 30-60% of women experience intermittent physical and/or psychological symptoms during the menopause,[90] and its symptoms can affect the quality of both personal and working life.[91]

A survey published by the UK's Parliamentary Women and Equalities Committee in February 2022 showed 31% of women took time off work due to menopause symptoms, which included problems with memory or concentration, anxiety/depression and headaches. Despite this, less than a third of respondents told anyone at work and just under 11% requested adjustments in the workplace due to their symptoms.

A report published by the same Committee months later concluded the lack of support from employers is pushing women out of work, and there are several movements in developed countries to push for a recognition of menopause as a protected characteristic in workers' rights.

HOW INVESTORS SHOULD CONSIDER VOTING

Investors should start by engaging in these topics and promote best practices which companies should follow. Due to the lack of a global framework of principles, data and metrics, and standards on social factors, voting against a company on this topic should be a decision only be taken if all engagement avenues have been exhausted.

Investors should consider voting against the approval of the Annual Report and Accounts if:

- FTSE 100 companies do not have a formal approach to workplace wellbeing disclosure, including mental health management and disclosure.
- After engagement initiatives with companies, there is insufficient progress on wellbeing activities disclosures.
- FTSE 350 companies fail to address the legal minimum requirements of the Modern Slavery Act.

Investors should consider voting against the re-election of the responsible Director if:

- Companies identified as highly exposed to modern slavery risks, or where there have been confirmed incident, fail to demonstrate an adequate risk management and a willingness to change their approach.
- Companies do not adopt sufficient measures to prevent, monitor, mitigate or remediate negative human rights impacts within its operations.

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[90] Ibid

[91] Department of Health 'Annual Report of the Chief Medical Officer, 2014', Department of Health (2015) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/595439/CMO_annual_report_2014.pdf>.

SECTION 8: CAPITAL STRUCTURE AND ALLOCATION

Capital structure and allocation is the process of distributing a company's financial resources to enhance the firm's long-term financial stability and to protect its capital value. It can appear unexciting – and so often receives little attention from investors – but a misjudged approach to this can contribute to corporate collapse and failure.

Capital allocation practices include repayment of debt, repurchasing of shares, paying final or interim dividends to shareholders and investment either in organic growth or in mergers and acquisitions activity. There are several stakeholders whose interests need to be balanced in any capital allocation decision, including the Defined Benefit (DB) pension scheme, shareholders, employers and customers. In addition, the appropriate ratios between profitability and dividend payments must be maintained.

Although some of the issues highlighted may seem technical or of low priority, investors should be alert to signs that the company continues to fail to honour shareholder rights. In 2016, BHS went into administration[92] following several corporate governance failures including the payment of illegal dividends. The total dividends paid by BHS Ltd between 2002 and 2004 were £414 million, almost double the after-tax profits of the company of £208 million.[93] For its part, Carillion paid out £376m over a five-year time period while generating £159m of net cash from operations.[94] Carillion also paid an interim and final dividend every year from 2010.

In recent years, there has been a significant increase in the number and proportion of initial public offerings (IPOs) that have dual-class share structures.[95] According to the Investor Coalition for Equal Votes, these structures – where a company has two or more share classes, and these differ in terms of voting rights – dilute the ability of minority shareholders to effectively hold companies to account.

The growth in the prevalence of dual-class share structures and the potential loosening of regulatory requirements around the use of dual-class shares raises important questions for investors concerned about the integrity and operation of capital markets.[96]

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[92] Murad Ahmed 'BHS goes into administration after sale talks fail', Financial Times (2016) <https://www.ft.com/content/3f83c690-0aad-11e6-b0f1-61f222853ff3>.

[93] Work and Pensions and Business, Innovation and Skills Committees 'BHS', Work and Pensions and Business, Innovation and Skills Committees (2006) <https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/54.pdf>.

[94] Federico Mor, Lorraine Conway, Djuna Thurley, Lorna Booth 'The collapse of Carillion', House of Commons Library (2018) <https://researchbriefings.files.parliament.uk/documents/CBP-8206/CBP-8206.pdf>.

[95] Ritter, J. 'Initial Public Offerings: Dual Class Structure of IPOs Through 2023', Warrington College of Business (2024) <https://site.warrington.ufl.edu/ritter/files/IPOs-Dual-Class.pdf>.

[96] Investor Coalition for Equal Votes 'Undermining the Shareholder Voice: The rise and risks of unequal voting rights', Investor Coalition for Equal Votes (2023) <https://cdn-suk-railpencom-live-001.azureedge.net/media/media/pmcil2eb/icev-report-2023-undermining-the-shareholder-voice.pdf>.

In their latest consultation on proposals for UK listings reforms, the FCA propose a more flexible approach to DCSS and do not intend to introduce any time-related sunset requirement to limit the exercisability of enhanced voting rights.

DIVIDENDS

Information on dividend structure, including both policy and practice, will be of interest both to equity investors who are looking for income or growth potential, and bond investors who are considering a company's long-term creditworthiness.

NEW SHARES

In company law, companies must secure shareholder approval to be able to issue new shares. Resolutions that allow the company to issue new shares are normally of two types: 'Section 551'[97] and 'Section 570'[98] Authorities.

Resolution types: Issuance of new shares

- *Section 551 Authorities* allow companies to allot new shares. Any amount in excess of one-third of existing issued shares should only be applied to fully pre-emptive rights issued in order to protect against shareholder dilution.
- *Section 570 Authorities* allow companies to issue shares for cash without the application of pre-emption rights. The Pre-Emption Principles are equivalent to 10% of the issued share capital at the time of the authority. An additional 10% is acceptable provided that the company confirms in its AGM that it intends to use this only in connection with an acquisition or specific capital investment – which is announced at the same time as the issue – or which has taken place in the preceding six-month period. A multi-year limit also applies to the issuance of shares for cash in connection with an acquisition of a specific capital investment (typically a maximum of 7.5% shares to be issued over three years without the application of pre-emption rights).

SHARE BUYBACKS

Takeover Code Rule 9[99] waivers are usually sought when a company proposes to institute a share buyback programme in which a large investor or concert party intends not to participate. This brings with it the risk of creeping control – which is a clear issue of concern to shareholders.

[97] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/551>.
[98] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/section/570>.
[99] The Panel on Takeovers and Mergers 'The Takeover Code' Thirtheen Edition, The Panel on Takeovers and Mergers (2021) < The-Take-Over_Bookmarked_20.2.23.1.pdf (thetakeoverpanel.org.uk)>.

Resolutions on dividends, share buybacks or issuance and debt constraints in articles need to be set within a considered capital structure framework. This framework should balance the need for shareholder returns with the long-term viability of the business.

EVIDENCE BASE

Dividend information can be found in several different corporate communications, including the Annual Report, interim accounts, press releases and preliminary announcements. It should be noted that companies often fail to clearly articulate the story of the dividend, from policy development – including the rationale for its approach – to declaration and payment. Although there should also be a justifying statement around the dividend, this does not always happen.

The viability statement should also provide a basis for an annual assessment and debate on capital structure. However, these rarely provide as much useful and high-quality information as they could – it is notable that the Brydon Review recommended the production of a Resilience Statement to perform a similar function.

Key metrics for investors to pay attention should include the "payout ratio," where dividends are set as a percentage of a defined metric (this could be earnings or free cash flow). Where this is used – and particularly when the ratio is not based on a defined IFRS metric such as earnings of cashflow – the rationale for the selection of metrics should be justified.

The Annual Report should disclose related party transactions which are significant, whether by virtue of their significance to the business, the individuals involved or the perception of potential conflicts.

WHAT DOES GOOD COMPANY BEHAVIOUR LOOK LIKE?

- Companies take capital structure decisions which balance the financing needs of the firm with the interests of broader stakeholders. This includes striking the right balance between dividend payments to shareholders and paying Deficit Repair Contributions (DRCs) to any DB pension scheme. In addition, this includes undertaking share buybacks only when doing so is the best way of achieving long-term value. Dividend resolutions should not simply be approved as a matter of course and moves that weaken a company's balance sheet – and so its long-term stability – are not in the long-term interest of the shareholder.
- Companies should adopt single-class share structures at IPO or as soon as possible thereafter. For any dual-class share structures where sunset clauses are not adopted, companies should adopt provisions that require periodic approval, at least every seven years, from a majority of each share class voting separately, for the dual-class share structure to continue, and adopt supplemental safeguards for pivotal proposals.

Dividends

- Companies have clear dividend policies. These should set out the circumstances for distributing dividends and returning capital to shareholders. There should be evidence that the financial position (especially distributable reserves), maturity and strategy of the business – including the necessary level of DRC to any DB scheme – have been appropriately considered and reflected. Investors should pay attention to the possibility of companies taking on more leverage to cover dividends to shareholders.
- Dividend policy disclosure is specific. The information given should be at a sufficiently granular level so that investors can understand what the policy means in practice, including the basis for deriving the proposed level of dividend and the specifics of how it is determined. It should describe the governance process over the policy decision, the risks and constraints associated with the policy and the timeframe over which the policy is expected to operate.
- There is a prudent level of interim dividends issued. Such dividends are usually decided solely by Directors without the need for shareholder approval. There is a growing trend for companies to pay only interim dividends, which is detrimental to the role of investor oversight on this issue. Where a scrip dividend or equivalent is issued, there should be a cash dividend also available.
- Shareholder approval is sought for the approval of the financial dividend. Should this not be the case, investors should strongly consider submitting a shareholder resolution or voting against the company's Report and Accounts, except where companies can compellingly demonstrate that changing their practice to seek shareholder approval of the dividend would significantly delay payment and materially disadvantage shareholders.

Share buyback

- There is a clear rationale – one that aligns with the interests of long-term shareholders – for any share buybacks undertaken. Share buybacks can, on occasion, be a useful tool for companies to manage their capital structure and most investors will support these repurchases, provided local market regulations and relevant shareholder guidance are met. However, share buybacks can be manipulated by managers whose pay is aligned with earnings per share, in a way which comes at the expense of long-term investors or the company's long-term success. Metrics and disclosure provided should cover:
    - The weighted average cost of shares bought
    - Total cost
    - Impact on key metrics for buybacks undertaken during the previous year
    - Clear explanation of the process used to identify when buyback is appropriate
    - The maximum price the company is willing to pay and the hurdle rate in respect to the buyback, linking to the overall capital management framework of the company.

Issuance of new shares

- The company recognises that pre-emption rights are important for the protection of stakeholder interests. Companies should seek to abide by the recommendations of the Pre-Emption Group UK Statement of Principles[100], except where they can make a clear case for these not being applied in the context of the best interest of the owners of the company concerned. To protect the rights of existing shareholders and reinforce the accountability of management to the company's owners, companies should avoid the creation of "poison pill" provisions except in exceptional circumstances.
- Any non-pre-emptive issue is clearly signalled at the earliest opportunity. Companies should also seek to establish a dialogue with investors at this stage. They must keep shareholders informed of issues related to an application to disapply their pre-emption rights. The Pre-Emption Group Principles should be followed.
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Related Party Transactions

- There is a robust and independent process for reviewing, approving and monitoring related party transactions (RPTs). This should include both individual transactions and in aggregate, as well as appropriate procedures to identify and manage conflicts of interest.
- There is a Committee of Independent Directors with the ability to take independent advice that reviews significant RPTs and the board confirms that all RPTs have been reviewed and met with its approval. The Committee's review should include aggregate levels of RPTs to determine whether they are necessary, appropriate and in the best interests of the company and shareholders.

HOW INVESTORS SHOULD CONSIDER VOTING

There are several different resolutions pertinent to various capital allocation issues, including approval of final dividend, issuance of new shares, market purchase of shares, and related party transactions.

Investors should consider voting against approval of the final dividend if:

- The dividend does not seem sustainable and appropriate, when considered in the context of the financial position, maturity and business strategy, or where issues such as DRC are not appropriately reflected.
- There is no cash dividend available as an option to a scrip dividend or equivalent.
- They have concerns regarding the accounting standards and assumptions used in the metrics provided.

[100] Financial Reporting Council 'Pre-Emption Group Statement of Principles', Financial Reporting Council (2022) <PEG_Statement-of-Principles.pdf (frc.org.uk)>.

<u>Investors should consider voting against a resolution on issuance of new shares</u> if:

- Section 551 and Section 570 Resolutions are bundled together. The issuance is not consistent with Pre-Emption Principles without a satisfactory explanation.

<u>Investors should consider voting against a resolution on market purchase of shares</u> if:

- The resolution proposes a waiver of Rule 9 of the Takeover Code.
- The buyback is not deemed a prudent use of the company's cash resources, is not supported by cash flows of the underlying business and introduces excessive and unsustainable leverage.

<u>Investors should consider voting against a resolution on related party transactions</u> if:

- An RPT has not been subject to proper oversight by the board and regular review (through the audit or shareholder approval).
- The RPT is not: clearly justified or beneficial to the company; undertaken in the normal course of business; on fully commercial terms; in line with best practice; or in the interests of all stakeholders.

It is important to caveat that within the FCA's consultation CP23/31 published in December 2023 where detailed proposals for UK listings reforms have been outlined, the proposed approach to the inclusion of a related-party transaction remains a disclosure-based regime. The FCA are not proposing requiring a shareholder vote in their latest consultation.[101]

<u>Investors should consider voting against a resolution on re-election of the Chair</u> if:

- There is an unsustainable level of interim dividends issued and they have reason to believe that this is being done to avoid shareholder scrutiny. Please note that this is a serious issue and if investors have concerns in this space, they could accompany this with a vote against the Annual Report and Accounts.
- Shares are issued outside of the Pre-Emption Group Principles.

Investors should consider voting against the Governance Committee Chair (or equivalent) if:

- Company has a dual class share structure without a sunset clause of seven years or less from the date of the IPO.

[101] Financial Conduct Authority 'CP23/31: Primary Markets Effectiveness Review: Feedback to CP23/10 and detailed proposals for listing rules reforms', Financial Conduct Authority (2023) <https://www.fca.org.uk/publication/consultation/cp23-31.pdf>.

SECTION 9: TAKING A HOLISTIC APPROACH

It is important for investors to take stock after working with their advisers and managers to consider their approach to voting on any company issues and to think about their views of the board as a whole. Voting decisions should be made in the context of a company's overall governance arrangements and should include consideration of the progress made.

Investors should also consider the level of responsiveness of the board to investor concerns. Although it is mandatory for companies to address significant dissent votes and explain how the board will address the concerns that have led to the dissent, Directors should be responsive to investor concerns throughout the course of the year and not just on a one-off basis, in specific circumstances. As a reference point, The Investment Association publishes a public register[102] with details of companies which have received significant opposition by shareholders to a resolution.

THE LEVEL OF DISCLOSURE

Investors need detailed and meaningful disclosures about a company's board and governance practices. Without this, it is very difficult to arrive at an informed opinion. Investors should reflect on whether the Annual Report adequately informs investors on the company's strategy, vision and business model.

If investors are unhappy with the level of disclosure overall or in key areas, this should be a significant factor in their holistic assessment of how to vote.

ACCUMULATION OF MINOR ISSUES

Although certain minor corporate governance issues would not generally trigger voting consequences, an accumulation of minor issues may be indicative of poor corporate governance and more deep-rooted issues at a company. This is particularly the case if there fails to be meaningful progress – despite expressions of concern and engagement from investors – and it appears that the company management does not prioritise shareholder concerns.

HOW INVESTORS SHOULD CONSIDER VOTING

Investors should consider voting against the Annual Report and Accounts if:

- Report has not fulfilled its purpose of giving insight into the company's strategy, vision and business model.

Investors should consider voting against the Chair or against the Senior Independent Director if:

[102] The Investment Association 'Public Register', The Investment Association (2023) <https://www.theia.org/public-register>.

- There are particularly serious concerns about the company's business model, plan or the implementation of its plan for engagement with long-term shareholders.
- The company seems unwilling to change its approach despite significant investor concerns.
- The company does not follow corporate governance provisions to respond to dissent.

Please note that where investors may wish to take the extremely significant step of voting against the whole board, they should be able to clearly articulate an alternative proposition for the board's approach.

APPENDIX 1: VOTING RECOMMENDATIONS SUMMARY

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Board Leadership and Company Purpose	Key stakeholder relationships, including with shareholders and the workforce, are being neglected and the board is not adhering to the spirit of the Corporate Governance Code requirement to engage and support stakeholder constituencies.	AGAINST	Annual Report and Accounts
Board Leadership and Company Purpose	Disclosure of the business model fails to convey how the company intends to generate and preserve long-term value.	AGAINST	Annual Report and Accounts
Board Leadership and Company Purpose	The company fails to provide a fair and balanced explanation of the composition, stability, skills and capabilities and engagement levels of the company's workforce.	AGAINST	Annual Report and Accounts
Board Leadership and Company Purpose	The Chair has declined a legitimate shareholder request for a meeting without offering a valid reason as to why or has failed to find a mutually convenient time without undue delay.	AGAINST	Chair
Board Leadership and Company Purpose	The Chair has repeatedly failed to address investors' concerns about the relationship between the company and key stakeholders.	AGAINST	Chair
Board Leadership and Company Purpose	The Chair has had significant involvement, whether as an Executive Director or a Non-Executive Director, in material failures of governance, stewardship or fiduciary responsibilities at a company or other entity.	AGAINST	Chair
Division of Responsibilities	There is a combination of the role of Chair and CEO without a convincing explanation as to why, where an 'interim' period extends for more than one year or where there is evidence of poor succession planning.	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Division of Responsibilities	Investors judge that the arguments presented to justify the succession of the CEO to Chair are insufficient. It is important to note that complexity of the business is unlikely to be sufficient explanation in itself.	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	The Chair is Director of more than four companies and/or a Chair of two or more global and highly complex companies (unless there is a compelling explanation as to why this will not impact their availability and commitment).	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	The situation of a combined role persists and there remains serious concern that the specific arrangements create unresolvable challenges for board oversight of executive management.	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	Material corporate governance failings under the Chair's watch are evident. This should include an inadequate response in addressing shareholder concerns.	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Division of Responsibilities	Investors should consider also voting against the election of the Director responsible for the appointment process (often the SID) when issues persist.	AGAINST	Chair; Director responsible for the appointment process; (Annual Report and Accounts)
Composition, Succession and Evaluation	There is limited or boilerplate disclosure about the board performance review and review of corporate governance arrangements.	AGAINST	Annual Report and Accounts
Composition, Succession and Evaluation	A diversity statement is not disclosed or is considered unsatisfactory based on our above recommendations of what good company behaviour should be.	AGAINST	Annual Report and Accounts
Composition, Succession and Evaluation	Practice does not improve regarding the composition and succession or there is consistently no independent board performance review conducted.	AGAINST	Chair

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Composition, Succession and Evaluation	If: • There is no evaluation process. • There is a failure to disclose a reassuring succession plan, even after engagement with shareholders. • The board is consistently failing to move closer to the latest FCA requirements on diversity and inclusion – or did not successfully explain the reason for non-compliance – the FTSE Women Leaders Review on gender diversity and the Parker Review recommendations on ethnic diversity. • The board has not established a diversity and inclusion policy and strategy. • The board is consistently failing to, or showing lack of effort to, move closer to our above recommendations of what good company behaviour should be regarding board diversity. • There is a failure to move to annual Director elections and an absence of an acceptable explanation.	AGAINST	Chair; Chair of Nominations Committee

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Composition, Succession and Evaluation	If: • Previous legitimate investor concerns have not been sufficiently addressed. • The Director has had significant involvement, whether as an Executive Director or Non-Executive Director, in material failures of governance, stewardship or fiduciary responsibilities at another company or entity. • Engagement with a Director has resulted in a judgement against their effectiveness and suitability, including with regards to conflict of interest. • There is no supporting statement from the board. • There is clear evidence of poor performance or poor attendance at meetings without provision of a satisfactory explanation. • There is concurrent tenure of a Non-Executive Director with an Executive Director for over nine years and no satisfactory explanation given as to why the Director remains independent. • The composition of the key Committees or the balance of the board has been compromised by the presence of one (or more) specific non-independent Non-Executive Directors. • There is failure of a specific aspect of reporting or function (with investors voting against the Director responsible e.g., the Chair of the relevant Committee). • There is no clear evidence that diversity is being sufficiently considered by the board, or where previously committed timescales are not being met, in the senior board positions.	AGAINST	Chair; Directors

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Audit, Risk and Internal Control	If there are ongoing concerns in relation to: • The audited accounts fail to provide a true and fair view of profit or loss, assets or liabilities (for example, they overstate profit or assets or understate likely liabilities such as pension or climate-related liabilities). Please note: if the Auditor is seen to have helped reveal this issue, then their re-election, all other things being equal, should be strongly supported. • There is ongoing use of alternative performance measures to report on business performance and their use is not transparent and fully justified, or where the reconciliation to the generally accepted accounting principles accounting numbers if unclear, or where the calculations change regularly in ways that appear to flatter management delivery. • There is poor disclosure of the strategy and risk exposures or a lack of disclosed review of the company's risk management and internal control systems. • There is either no viability statement which looks out over multiple years, or one which does not evidently consider a full range of risk factors. • The climate change assumptions that underlie calculations of relevant and publicly stated asset valuations or business profits are not sufficiently transparent or appear to be inconsistent with science and expert opinions on climate change. • The company's disclosure on cybersecurity risk – and on steps to mitigate this risk – is particularly poor.	AGAINST	Annual Report and Accounts; Auditor; Audit Committee Chair

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Audit, Risk and Internal Control	If: • The tenure of an external Auditor extends beyond ten years and there has not been a recent tender process and where no plans to put the audit service out to tender are disclosed. • The Auditor has been in place for more than 20 years. • The non-audit fees exceed 50% of the audit fees in consecutive years without an adequate explanation being provided. • There are major concerns regarding the audit process and quality of accounts – particularly a failure to provide a true and fair view (or good visibility over the payment of dividends) and these are not resolved satisfactorily by the board. • Cybersecurity risks (or any breach responses) are not being sufficiently well managed.	AGAINST	Audit Committee Chair; Reappointment of Auditor
Audit, Risk and Internal Control	If: • The Auditor's Report fails to address a key issue or is otherwise unsatisfactory. • Audit fees have been either increased or reduced by a significant proportion (e.g. more than 20%) in a given year without a clear justification.	AGAINST	Auditor's remuneration; reappointment of Auditor
Audit, Risk and Internal Control	There are extreme concerns or persistently poor disclosure in regards to the sufficient auditing of the company.	AGAINST	Chair
Audit, Risk and Internal Control	There is evidence of egregious conduct attributable to a particular Director around the development and deployment of AI.	AGAINST	Director; Chair

Remuneration	If: • The company's remuneration policy fails to meet the standards outlined above. • Pay policies may result in pay awards that could bring the company into public disrepute or foster internal resentment. • The pay policy awards 'sign-on' bonuses without the inclusion of any conditionality, or allows for the payment of awards not already vested at the previous employer. • The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support. This represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role. • There is no provision to enable the company to claw back sums paid or scale back unvested awards. Such provisions should not be restricted solely to material misstatements of the financial statements. • The pension payments or payments in lieu of pension (as a percentage of salary) for new appointments are not in line with the proportion paid to the rest of the workforce. • There is no plan to bring pension payments to incumbent Directors in line with the proportion paid to the rest of the workforce over the next few years. • There is an excessive amount of flexibility being provided for 'exceptional circumstances'. • The recruitment policy is vague and unlimited or substantial headroom is given and not accompanied by substantial additional hurdles.	AGAINST	Remuneration policy

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
	• There are guaranteed pensionable, discretionary or 'one-off' annual bonuses or termination payments. • There is any re-testing of performance conditions to enable awards to be made. • New share award schemes are layered on top of existing schemes.		

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Remuneration	If: • There is insufficient evidence of alignment with shareholders' interests and company long-term strategy. This could include, but is not limited to, a shareholding requirement for which the level is set at less than 2x salary. • The metrics used are inappropriate or there are insufficiently stretching targets for annual bonus or LTIP. • There are annual pay increases in excess of those awarded to the rest of the workforce and an absence of a convincing rationale. • Pension payments to incumbent Directors (as a percentage of salary) are higher than the rest of the workforce and there is no evidence that this will be reduced. • The pension payments, or payments in lieu of pension (as a percentage of salary) for new appointments, are not in line with the proportion paid to the rest of the workforce. • There is a failure to disclose (or to have a retrospective disclosure of) variable pay performance conditions for annual bonuses or ex-gratia and other non-contractual payments. • There is a change in control provisions which trigger earlier and/or larger payments and rewards and there is an absence of service contracts for executive Directors. • The process of engagement prior to the AGM vote fails to produce a remuneration policy that shareholders can support – this represents a serious failure on the part of the Chair of the remuneration committee in what is the most fundamental aspect of their role.	AGAINST	Remuneration Report

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Remuneration	If: • The company has repeatedly failed to take investors' concerns into account and fail to respond in what investors consider to be an appropriate fashion. • The process of engagement pre-AGM has failed to result in a remuneration policy that shareholders can support, or shareholders feel that the Chair has failed to take on board their concerns about the Remuneration Report. • Any revised policy continues, on a repeat basis, to fail to meet the principles outlined above.	AGAINST	Remuneration Committee Chair (if in post for over one year)
Climate Change and Sustainability	If: • There is insufficient disclosure on how a company intends to monitor and manage the risks and opportunities brought about by climate change. • The business has operations which are highly carbon intensive and there has been no disclosure of the climate-related assumptions which underlie their financial calculations, or where those assumptions are not consistent with the Paris Agreement. • The business has operations which are highly carbon intensive and there is no commitment to disclose memberships and involvement in trade associations that engage on climate-related issues.	AGAINST	Annual Report and Accounts

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Climate Change and Sustainability	If: • There are no plans to align senior Executive remuneration to performance against relevant sustainability metrics within a reasonable timeframe. • The business has operations which are highly carbon intensive and has not included at least one climate-related metric in the calculation of executive incentives. The metrics also should not be contradictory.	AGAINST	Remuneration policy

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Climate Change and Sustainability	If: • Shareholders have attempted to engage on the issue and companies have still failed to demonstrate effective board ownership, for example providing a detailed risk assessment and response to the effect of climate change on the business, or incorporating appropriate expertise on the board. • The business is not already moving towards disclosures consistent with mandatory TCFD obligations or, where relevant CDSB, SASB or another established third party framework. For smaller businesses, they are not readying themselves at a pace proportional to the resources available and the TCFD roadmap. • The business has operations which are highly carbon intensive and has not made sufficient progress in providing the market with investment relevant climate disclosures including committing to publish science-based targets. • The company has not listened to investor concerns about any direct or indirect corporate lobbying activity whose objectives are considered to frustrate climate change mitigation. • The company has not responded appropriately to the result of a climate change related resolution, whether binding or not, and whether it was passed or not. • The company efforts to mitigate agricultural commodity-driven deforestation are considered insufficient.	AGAINST	Directors; Chair
Climate Change and Sustainability	Investors should also consider voting in favour of relevant climate-related or similar resolutions – including Say on Climate resolutions – by making assessments on a case-by-case basis.	FOR	Shareholder resolution

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Social Factors and Workforce	If: • FTSE 100 companies do not have a formal approach to workplace wellbeing disclosure, including mental health management and disclosure. • After engagement initiatives with companies, there is insufficient progress on wellbeing activities disclosures. • FTSE 350 companies fail to address the legal minimum requirements of the Modern Slavery Act.	AGAINST	Annual Report and Accounts
Social Factors and Workforce	If: • Companies identified as highly exposed to modern slavery risks, or where there have been confirmed incident, fail to demonstrate an adequate risk management and a willingness to change their approach. • Companies do not adopt sufficient measures to prevent, monitor, mitigate or remediate negative human rights impacts within its operations.	AGAINST	Directors
Capital Structure and Allocation	If: • The dividend does not seem sustainable and appropriate, when considered in the context of the financial position, maturity and business strategy, or where issues such as DRC are not appropriately reflected. • There is no cash dividend available as an option to a scrip dividend or equivalent. • They have concerns regarding the accounting standards and assumptions used in the metrics provided.	AGAINST	Approval of the final dividend
Capital Structure and Allocation	• Section 551 and Section 570 Resolutions are bundled together. The issuance is not consistent with Pre-Emption Principles without a satisfactory explanation.	AGAINST	Issuance of new shares

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Capital Structure and Allocation	If: • The resolution proposes a waiver of Rule 9 of the Takeover Code. • The buyback is not deemed a prudent use of the company's cash resources, is not supported by cash flows of the underlying business and introduces excessive and unsustainable leverage.	AGAINST	Market purchase of shares
Capital Structure and Allocation	If: • An RPT has not been subject to proper oversight by the board and regular review (through the audit or shareholder approval). • The RPT is not: clearly justified or beneficial to the company; undertaken in the normal course of business; on fully commercial terms; in line with best practice; or in the interests of all stakeholders.	AGAINST	Related party transactions
Capital Structure and Allocation	If: • There is an unsustainable level of interim dividends issued and they have reason to believe that this is being done to avoid shareholder scrutiny. Please note that this is a serious issue and if investors have concerns in this space, they could accompany this with a vote against the Annual Report and Accounts. • Shares are issued outside of the Pre-Emption Group Principles.	AGAINST	Chair
Capital Structure and Allocation	• Company has a dual class share structure without a sunset clause of seven years or less from the date of the IPO.	AGAINST	Governance Committee (or equivalent) chair
Taking a Holistic Approach	• Report has not fulfilled its purpose of giving insight into the company's strategy, vision and business model.	AGAINST	Annual Report and Accounts

ISSUE	PLSA STATEMENT	VOTE OUTCOME (VOTE)	VOTE OUTCOME (RESOLUTION)
Taking a Holistic Approach	If: • There are particularly serious concerns about the company's business model, plan or the implementation of its plan for engagement with long-term shareholders. • The company seems unwilling to change its approach despite significant investor concerns. • The company does not follow corporate governance provisions to respond to dissent.	AGAINST	Chair; Senior Independent Director; (Board)

APPENDIX 2: FURTHER READING AND RESOURCES

- **The ICGN Global Governance Principles**

These globally accepted standards of best practice provide a sound foundation for the development of market-specific codes of best practice for investors to adopt and support as part of their corporate governance programmes.

- **The QCA Code for Small and Mid-Size Quoted Companies**

While the UK Stewardship Code, at the moment, only applies on a mandatory basis to companies with a premium listing, its principles are just as relevant to smaller quoted companies as they are to larger ones. The Quoted Companies Alliance (QCA) Corporate Governance Code for Small and Mid-Size Quoted Companies is a useful reference point for companies in this respect. In judging practice, investors should be mindful of the individual circumstances of the business, reflecting upon its size and complexity. A key focus for smaller quoted companies should be to seek regular and constructive engagement with their shareholders.

- **The AIC Code of Corporate Governance (Investment Companies)**

Investment Companies have specific characteristics which commonly lend themselves to alternative governance approaches than those set out in the Code. To that end, the Association of Investment Companies (AIC) Code of Corporate Governance forms a comprehensive guide to best practice. Of particular importance to shareholders is that the board is, and acts, fully independently of the firm providing fund management services. The board of these companies is crucial in ensuring that shareholders are provided with sufficient information for them to understand the risk/reward balance to which they are exposed by holding the shares.

- **The UK Corporate Governance Code (2018)**
- **The UK Corporate Governance Code (2024 – effective 2025)**
- **The UK Stewardship Code (2020)**
- **OECD Principles**
- **IVIS Guidelines**
- **GC100 and Investor Group Guidance on Directors' Remuneration Reporting**
- **The Report on the Taskforce on Pension Scheme Voting Implementation**
- **Institutional Investors Group on Climate Change**
- **Climate Action 100+**

- **Financial Reporting Council** **Corporate Governance and Stewardship mythbuster**

PLSA POLICY & RESEARCH LIBRARY

- **PLSA** **Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds**
- **The PLSA** **Voting Reporting Template and Implementation Statements Guidance**
- **Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers**
- **PLSA** **Engaging the Engagers: A Practical Toolkit to Help Schemes to Achieve Effective Stewardship Through Their Managers**
- **How Do Companies Report on Their Most Important Asset?**
- **Worthwhile Workforce Reporting: Good Practice Examples From the UK's Biggest Companies**