The Relevance and Future Challenges of the Listed Company AGM.

"A little more Chablis for you, sir?"

"Some port before coffee is served, madam?"

These are certainly not phrases normally heard at today's listed company AGMs but were commonplace a few short years ago. At that time, annual meetings between boards of directors and shareholders were partly social occasions conducted over lavish lunches. These days, AGMs are solely functional affairs (with hardly a decent biscuit in sight) which serve as the locus of the annual exercise of the rights and powers of the shareholders. They offer the members an opportunity to vote on certain resolutions and thereby to hold boards of directors to account. As principal author of UK governance standards, the FRC holds that in terms of accountability, the "key relationship is between the company and its shareholders, not between the company and the securities regulator or stock exchange" which is why the business of the AGM is crucial to good governance.[1] This essay will seek to argue that both the relevance and future development of the AGM are intrinsically bound up with the challenges of remedying shareholders' lack of engagement with the crucial votes which take place there, in particular those involving director re-election and remuneration policy.

Is the AGM as a meeting still valued by the members, notwithstanding the demise of lunch? The evidence suggests that it is not. Much of the reason is due to the changes in the composition of the shareholder base in the last few decades. Shareholders in listed companies are now almost evenly split between UK and overseas; the latest survey from the ONS shows that foreign ownership of UK equities has risen from 4% in 1981 to 54% in 2014. Individual shareholders held in excess of 50% of shares in the 1950's but now hold only around 10%.[2] Some still do attend AGMs, in stark contrast to the majority of UK institutional investors who appear to regard AGM attendance as an unnecessary nuisance. An Investment Association survey in 2015 found that 52% of UK asset managers actually have a *policy* of never attending them, up from 37% in 2010, and a mere 3% attend "wherever possible".[3] Not surprising, perhaps, when UK equities form such a diminished element of most asset managers' portfolios, and a large number of AGMs are crowded into a relatively short space of time.[4] And even with

[1] FRC, *The UK Approach to Corporate Governance*, (London; FRC,2014), p.3.
[2] Data from Office of National Statistics, 'Ownership of UK Quoted Shares, 2014.'
[3] Investment Association, *Adherence to the FRC's Stewardship Code*, London; Investment Association, 2015), p.23, Table 22.
[4] Investment Association, *Asset Management Survey, 2015-2016*, (London; Investment Association, 2016). Data shows that only 13% of the holdings of asset managers surveyed are invested in UK equities.

the generalised adoption of electronic proxy voting, ICSA reported quorum levels of only 72.4% for FTSE 100 companies in 2016, a level which has held constant for some years. It also noted that overseas investors have "historically been less likely to exercise their vote at UK general meetings."[5]

More widespread use of electronic meeting technologies may make a difference to participation levels by providing easier access to the AGM, especially for foreign investors. In June 2016, Jimmy Choo plc. became the first UK company to deliver an entirely electronic AGM. Arrangements were put in place for electronic proxy voting and for shareholders to dial in to listen to the Chairman and to ask questions, accessing the meeting via mobile, tablet or desktop.[6] They must have been grateful to have been spared the trouble of a long and expensive commute since (not unusually for UK companies) "the AGM lasted approximately thirty minutes."[7] With the duration of meetings so limited, there are clear advantages to the wider use of virtual meeting technologies and it seems certain they will be universally employed within the next decade. Although there are obvious cost savings and environmental benefits from electronic meetings, so long as a legal obligation to hold AGMs persists they are likely to continue in their present physical form, enhanced by the wider shareholder access offered by new technology.

The substantive business of the AGM rather than its format is far more crucial in terms of governance and it is here that greater reforms should be considered. It is the resolutions put before shareholders that are assumed to be vital in ensuring accountability in the UK Corporate Governance Code (UKCGC), and none more so than the compulsory votes on the election and re-election of directors. Here, the UKCGC's statement of principle is unequivocal: "The shareholders' role in governance is to appoint the directors."[8] As well as the re-election of sitting directors at AGM elections, the Companies Act 2006 also allows shareholders holding at least 5% of the voting shares to add resolutions to the business of the AGM, which can include the nomination of a non-executive director. In reality, this power is only ever exercised in extremis, being held in reserve exclusively for use when an unbridgeable gulf exists between the board and major shareholders.

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5 D. Vitale, *2016 AGM Season Review*, (London; ICSA, 2016). Accessed at: https://www.icsa.org.uk/knowledge/governance-and-compliance/features/november-20162016-agm-season-review.

6 Equiniti, *AGM Trends 2016*, (London; Equiniti 2016), pp.5-6.

7 Practical Law, *Annual Reporting and AGMs 2016*, (London: Thomson Reuters,2016), p.26.

8 FRC, *UK Corporate Governance Code*, (London; FRC, 2014), 'Governance and the Code.'

The empirical evidence regarding shareholders' exercise of discretion in wielding this important power at AGMs shows how little it is used. The average vote in favour of direction election and re-election has been around 99% for the FTSE 250 for the last three years.[9] In forty two companies there was a "substantial" shareholder vote against a director but in only six cases did the companies concerned issue a statement explaining the company's response to the vote, as they are guided to by the provisions of the UKCGC Section E 2.2.[10] That extremely few directors have ever failed to be re-elected suggests either an extraordinarily high level of shareholder satisfaction with their performance or that such votes are merely formalities. In recent comments, Lord Myners opted for the latter explanation, remarking that directors "are elected with North Korean-like majorities by uninterested shareholders, selected through a process led by the chairman which would also be familiar to those in Pyongyang."[11]

Notwithstanding the colourful metaphor, the situation does seem unsatisfactory in terms of the requirement that boards should be accountable to shareholders. Last year the High Pay Centre published a report suggesting that the UK adopt the Swedish model of Shareholder Committees which would have five members made up of representatives from the five largest shareholders.[12] They would replace the Nomination Committee in making recommendations to the AGM on the re-election of directors and in seeking new ones. Another of their duties would be to "approve the pay policy and specific pay packages proposed by the Remuneration Committee before they are put to a binding vote of all shareholders at the AGM."[13] The Shareholder Committee would include an employee representative and have the right to ask questions requiring a response from the main board on corporate strategy. Although instituting such committees may improve accountability, the authors themselves admit there are practical difficulties around insider status, the process following the sale of representatives' shareholdings, and the workload and costs to the investors (especially overseas institutions) that make implementation problematic.

Recent developments in the US may offer a better model. There has been substantial movement towards companies incorporating proxy access into their governance mechanisms

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[9] Proxy Monthly, *Voting News: The Calm before the Storm*, Volume 3; Issue 9, 2016 (London; Proxy Insight, 2016), p.3.

[10] Practical Law, *Annual Reporting and AGMs 2016*, (London; Thomson Reuters, 2016), p.33. There is no fixed definition of "substantial" but in this report it is taken to be 10%.

[11] High Pay Centre, *Restoring Responsible Ownership: Ending the Ownerless Corporation and Controlling Executive Pay*, (London; High Pay Centre, 2016), p.7. Lord Myners was the leading figure behind the *Myners Report*, (2001), an influential investigation of the relationship between companies and institutional investors.

[12] Ibid.

[13] Ibid, p.20.

with around 20% of S&P 500 companies adopting this in the last year. This allows shareholders either individually or as a group of up to twenty who have held a minimum of 3% of the company's outstanding shares for at least three years to nominate director candidates onto the ballot alongside the board's nominees. It is usually capped at 2 directors or 20% of the total number of directors. In the two new corporate governance codes recently proposed by major US asset managers and owners, this is represented as a crucial way of operationalising the principle that boards should be accountable to shareholders.[14] The movement is backed by evidence from large scale studies in the US that found a positive correlation between proxy access and greater board accountability, and increasing shareholder wealth.[15] Granting provision for proxy access for shareholders to propose directors for election as part of the business of the AGM (subject to similar qualifications as in the US) could be considered in the UK as a way of better engaging shareholders with constituting the board.

To enable shareholders to make informed decisions on how to cast their votes on director elections, it might also be helpful if more information on board evaluations were made available to them. Section B.2 of the UKCGC requires the board to undertake a "formal and rigorous annual evaluation of its own performance and that of its committees and individual directors."[16] Although there is some reporting on the process of board evaluation in annual reports, investors are concerned that it "is often too boilerplate, with little insight into what the issues are or how the board is going to address these going forward."[17] In terms of accountability, can a closed circle of internal review (albeit one that must be facilitated by an external party at least once every three years) whose major findings are not disclosed to shareholders really be optimal? Although directors' rights to confidentiality need to be respected, if shareholders are to play the meaningful role in ensuring accountability, then they need a better understanding off individual directors' contributions to the unitary board.

This is not to suggest that director evaluations should be placed in the public domain. But it seems anachronistic that a significant proportion of directors admit in private that some of their

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[14] See Investor Stewardship Group, *Corporate Governance Principles for US Listed Companies* (accessed at https://www.isgframework.org/corporate-governance-principles/) and *Common-sense Principles of Corporate Governance* (accessed at http://www.governanceprinciples.org/wp-content/uploads/2016/07/GovernancePrinciples_Principles.pdf).

[15] CFA Institute, *Proxy Access in the US*, (New York: CFA Institute, 2014), p.8, Table 1. See also Norges Bank Investment Management *Proxy Access at US Companies: Position Paper* (accessed at https://www.nbim.no/globalassets/documents/position-paper-proxy-access.pdf).

[16]The UKCGC Section B.6 covers director evaluation and Section B.7 director re-election. Shareholders are provided with some basic biographical information and committee memberships etc.

[17] Practical Law, *Annual Reporting and AGMs 2016* (London; Thomson Reuters, 2016), p.8.

peers are performing at an unacceptably low level and should be replaced, whilst shareholders are kept in the dark. In the US, a recent survey conducted by PwC found that 35% of directors believe at least one person on their board should be replaced (for reasons of unpreparedness, lack of expertise or aging) and there is little reason to suppose that the figure would be much different in the UK.[18] So it is worth considering whether - subject to the same shareholding and tenure qualifications as proxy access - major shareholders should be able to obtain summary reports on directors' performance so that their votes on election and re-election resolutions put forward at AGMs can be more informed ones.

Turning now to another key area of shareholders' AGM voting powers, there are a large number of binding votes on pay policy due to be held by FTSE 350 companies during 2017. The proposed policies will show how responsive directors have been to concerns recently expressed by major asset managers over the dislocation between executive compensation and company performance. Such concerns are, of course, nothing new as this is a problem which now has a very long history. Executive compensation has been an issue which has flared up at regular intervals ever since Cedric, the twenty-stone pig, made an appearance as part of a shareholder protest against CEO pay at the British Gas AGM in 1995. Despite plenty of research conducted in the interim showing little or no positive correlation between levels of executive remuneration and long term company performance, there has been an inexorable rise in levels of compensation which shareholders have failed to stem, with average CEO pay increasing from c.£1m in 1998 to c.£4.3m in 2015.[19] A study published last year found that "big company bosses enjoyed pay rises of more than 80 per cent in a decade, whilst performance as measured by economic returns on invested capital was less than 1 per cent over the period."[20] By contrast, average earnings fell 9% from 2008-2015 and average wages are not expected to regain 2008 levels until 2021.[21]

AGM pay policy votes will be subject to a great deal of press coverage this year because of public interest in spiralling CEO/median pay ratios. Politically, it lies at the heart of the UK Government's corporate governance agenda; the very first question asked in the recent *Green*

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[18] PwC, *2016 Annual Corporate Directors Survey: Board Composition and Diversity* (accessed at http://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/board-composition-and-diversity.html)
[19] DBEIS, *Corporate Governance Green Paper*, (London; DBEIS, 2016), p.17.
[20] CFA, *Executive Remuneration Report 2016*. Accessed at: https://www.cfauk.org/media-centre/cfa-uk-executive-remuneration-report-2016.
[21] G. Tetlow, 'British workers face worst decade for pay in 70 years,' (London; *Financial Times*, 24th November, 2016).

Paper is: "Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance?" Unfortunately, it's the wrong question to ask. Just as on the issue of director re-election, the problem is not the weakness of their existing powers, but how supine shareholders have been about using them. Despite the extraordinary inflation in levels of remuneration, since the introduction of the pay reforms in 2013 "only one company has lost a binding vote on pay policy and six have lost advisory votes on their remuneration report."[22] If AGMs are to be relevant in the future, shareholders' rights to vote on pay policy resolutions must be exercised more critically and productively.

There are two possible reforms which may aid in this. The first is to research the link between the growing complexity of remuneration policies to see if evidence exists linking this to increasing shareholder value. If not, then mandating a reversion to simpler, more transparent policies with standardised and generally comprehensible linkages between compensation and total shareholder return as part of the next revision of the UKCGC should be considered. Secondly, and also as part of an updated UKCGC, binding votes on pay policy presented to the AGM should be subject to special resolutions requiring a 75% (or possibly even 85%) majority. To ensure shareholder dissent carries meaningful consequences, if resolutions fail there should be a requirement in the UKCGC to hold another vote within three months on a revised policy with only base salary to be paid out to directors while the board is in dispute with shareholders. Currently, the consequences of shareholder dissent from passed resolutions are too weak. For example, in 2016 amongst FTSE 350 companies, 60 AGM pay-related resolutions were passed with more than 20% votes against but in 29 cases, companies did not even "make any statement about how they intended to engage with shareholders after the vote."[23]

The AGM has a long history as the annual congregation of the members and directors of UK listed companies. However, as a recent ICSA report concluded, as a meeting "the value of the AGM is questionable in its current form, when few shareholders participate and the votes have already been decided in advance."[24] In terms of the substance of the votes, the proposals suggested here may offer some scope for improvement. However, the bottom line is that with equity ownership so fragmented, internationally diversified, and frequently short-term, to have shareholders perform the accountability role assigned to them in the corporate governance framework is coming to seem increasingly anachronistic. The evidence from the last decade,

[22] DBEIS, *Corporate Governance Green Paper*, (London: DBEIS, 2016), p.20.
[23] FRC, *Developments in Corporate Governance 2016*, (London; FRC, 2017), p.18
[24] ICSA, *The Future of Governance; Untangling Corporate Governance*, (London: ICSA, 2017), p.17.

following the global financial crisis of 2007-2008 and soaring levels of executive compensation, suggests that their report card might read ‘could do better’ and quite certainly ‘must try harder.’ But perhaps the real problem is that they are tasked with a duty that changes in the ownership structure of UK equities mean they are no longer equipped to carry out. With the outcome of the Government’s *Green Paper* awaited and with the FRC planning a fundamental review of the UKCGC in 2017, the time to think afresh about the relationship between boards of directors and shareholders is now well and truly upon us.

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