

THE
INVESTMENT
ASSOCIATION

GOOD STEWARDSHIP GUIDE 2021

February 2021



ABOUT THE IA

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad.

Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. IA members hold in total over one third (36%) of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account.

HELPFUL DEFINITIONS

Investors

A person or organisation that puts money into financial products or businesses with the expectation of achieving a profit.

Shareholders

A person, company, or institution who owns shares, known as equity, in a company. Shareholders are essentially the owners, they reap the benefits in the form of increased share valuations, or as financial profits distributed as dividends, and have the right to vote on how the company is run. It is important to remember shareholders are putting their money at risk to seek an investment return.

Annual General Meetings (AGMs)

Companies are required to hold an AGM each year. It is one of the key ways that shareholders hold the Board to account for the decisions made during the past year. Any shareholder who owns at least one share in a company can attend and vote at the company's AGM on issues, such as appointments to the company's board of directors, executive remuneration, dividend payments, and the selection of auditors.

Stakeholders

A stakeholder is a party that has an interest in a company and can either affect or be affected by the business. The primary stakeholders for a typical large business are its investors, employees, customers, government, suppliers and local community. This would include being held accountable for their impact on the environment.





WHAT IS STEWARDSHIP

“Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”

*Financial Reporting Council (FRC),
UK Stewardship Code, 2020.*



INTRODUCTION



The way companies go about their business has an impact on much more than their bottom line. Management decisions have an impact close to home – creating jobs, providing opportunities to suppliers and contributing to the wellbeing of their local communities.

The UK's biggest listed companies, and those in the FTSE 100 index in particular, collectively create millions of jobs, pay billions of pounds in tax and have a presence in almost every region in the country.

Businesses serve a useful purpose. Not only do they exist to provide goods and services that people want and need but by creating those jobs and paying taxes, companies provide for employees' financial wellbeing, contribute to the identity of communities, and help to fund our public services.

But a company's impact can go way beyond those who interact directly with it. The impact of climate change, for example, goes beyond borders and has the potential to change the fabric of our planet and everyone's way of life. The crisis triggered by the coronavirus pandemic only reinforces the understanding that natural events have a huge impact on the financial success of individuals, companies and whole economies. Climate change is one of the single biggest systemic risks facing business, society and the planet today and investors have made an industry commitment to deliver on the urgent need for climate action.

Ultimately this matters to the bottom line too. A company which neglects to understand its impact on people and the planet and doesn't think about the long-term changes to the communities it serves is unlikely to be making sound judgements on the risks and opportunities it will face as a business.

This is why shareholders engage with companies to understand their strategy and how they are adapting their business model to ensure they continue to thrive. The issues that face individual companies are multiple, complex, and sometimes unique to that business. This guide provides an overview of some of the key themes which are common to all UK listed companies and on which shareholders will be shining a spotlight in 2021.

STEWARDSHIP: HOW INVESTMENT MANAGERS HOLD BUSINESS TO ACCOUNT

Investment managers want companies to generate sustainable value over the long term for their clients. The activities undertaken by investment managers to promote the long-term success of companies are collectively known as 'stewardship'.

Stewardship involves looking at a range of issues which impact on the long-term performance of the company. These include strategy and financial performance, corporate governance (including executive pay, diversity of the board and management, succession planning, culture and stakeholder engagement), productivity and capital management, audit and accounting, and environmental and social issues, including climate change.

Stewardship works best when it is focusing on the right issue for the right companies at the right time. Investment managers have a number of tools at their disposal to hold companies to account. One of the most powerful and visible is voting at a company's AGM. But many other equally useful engagements happen all year round.



There are a number of ways in which investors engage with companies:



Setting expectations

Investors set out their expectations of companies in their stewardship, responsible investment and voting policies and communicate these expectations regularly in direct engagement with management and board members.



Research

Investors research and assess which companies will help meet clients' investment goals. They conduct this research in due diligence exercises prior to investment and on an ongoing basis to inform their investment and engagement approach.



Monitoring

Ongoing monitoring of investee companies to assess the risks and opportunities to long-term value.



Engage

Investors engage with the companies they invest in year-round to ensure that their expectations are being met. In dialogue with company management and board members, investment managers raise issues which they think pose a material risk to the company and want to understand how companies are managing those risks and responding to their concerns or views.



Collaboration and escalation

If investment managers don't think that companies are listening to their views, they may escalate their engagement. This might involve working with other shareholders either formally (through organisations such as the Investor Forum) or informally, requisitioning resolutions at an AGM or GM, or making public statements. Another mechanism is to formally write to the whole board where they have serious and unresolved concerns which have not been addressed by the CEO or chair.



Exercising rights and responsibilities

Investors make use of voting and other rights as shareholders to influence company behaviour. If companies listen to their shareholders then AGMs can for example take place without significant dissent. Otherwise, investment managers will express a view on the board by voting at AGMs or proposing their own resolutions to be voted on. A company that experiences a significant vote against will be named on the IA's Public Register.



Investment choices

Active managers will buy and hold companies and assets that help them to achieve their client's investment goals and sell those that won't. Exiting an investment due to stewardship concerns can be seen as the last resort, when all other approaches and engagement has resulted in no change. However, it can also be used as a first port of call – refusing to invest in companies where there are concerns about ESG criteria.



IMPROVING STEWARDSHIP IN THE UK

Historically stewardship and corporate governance focused on voting and engagement in listed equities. This narrow focus doesn't recognise the increasing prominence that debt and other asset classes play in our financial system and the need to better reflect the requirements of savers.

To improve the practical application of stewardship practices, a significant new report, *Investing with Purpose: placing stewardship at the heart of sustainable growth*, to which the IA provided the secretariat, has been launched. Two working groups, made up of investment managers and stakeholders, were established to look at how stewardship and responsible investment could be strengthened in the UK. They worked closely with Government and regulators and their report sets out a series of detailed recommendations to ensure the UK maintains and enhances its position as an international centre of excellence in stewardship.

The report provides a blueprint for an economy-wide approach to stewardship, to ensure investment supports long term returns and benefits, not just for the millions of savers our industry serves, but also for the economy, the environment and society. This has never been more important as the UK adjusts to life outside of the EU and seeks to build back better from the coronavirus pandemic.


The report builds on the principles set out in the Stewardship Code to encourage its practical application right across the investment chain. The IA is working hard with stakeholders to see the report's recommendations adopted and implemented. These include:

- Widening the adoption of the new UK Stewardship Code
- Improving companies' reporting and disclosure
- Expanding stewardship beyond the traditional focus on equities
- Embedding better stewardship in pension assets
- Improving shareholder participation



OPPORTUNITY FOR GLOBAL LEADERSHIP

2021 sees the UK host the G7 and COP26 summits. High on the agenda for world leaders to discuss will be tackling climate change. Effective stewardship practices would do much to help stem climate change. The IA is working in partnership with policymakers here in the UK and internationally to see stewardship play its role in combatting climate change.





VOTING AT AGMs AND THE ROLE OF SHAREHOLDERS

Listed companies are required to hold an Annual General Meeting (AGM) each year. It is one of the key ways that shareholders – who own shares in the company – hold the board to account for the decisions they make.

Any shareholder owning at least one share in a company can attend and vote at the company's AGM.

Decisions on how to vote are typically informed by views from across the investment business from fund managers and in-house governance experts who talk to the management teams of the companies they invest in all year round. The in-house view is also informed by external research services which provide detailed analysis of listed companies.

The IA's research service, the **Institutional Voting Information Service (IVIS)**, provides independent analysis on listed companies in the FTSE All-Share and FTSE Fledgling Index, to help shareholders reach a decision on how to vote at AGMs. IVIS analyses all public documents provided ahead of a company's AGM and produces a detailed report containing key information on voting matters, the company's compliance with the UK Corporate Governance Code, and on environmental, social and governance issues.

The issues voted on at an AGM will include matters like executive pay, appointment and re-election of the company's board of directors, dividend payments, the appointment and remuneration of the company's auditors and the approval of the annual report and accounts.

THE IA PUBLIC REGISTER

In 2017, the Investment Association was asked by the UK Government to establish the world's first Public Register of listed companies which have experienced significant shareholder rebellions (any vote of 20% or more against the management's recommendation is considered significant).

Appearing on the Public Register should act as a warning to companies that their shareholders are concerned about aspects of the company's governance. Once companies appear on the Public Register the FRC expect them to make a public statement within six months, on the action they have taken since the vote to address shareholders' concerns.

As the Public Register enters its fifth year, companies are doing more to acknowledge shareholder dissent, with 88% of firms now making a public statement acknowledging concerns and outlining how they plan to engage with shareholders – an increase from 58% in the register's first year.



SHAREHOLDER DISSENT IN 2020

Given the huge impact on business of the COVID-19 pandemic, the IA, on behalf of the UK's investment management industry, wrote to the Chairs of all FTSE 350 companies, expressing the industry's commitment to supporting British business through the crisis. This was to provide reassurance to company boards to allow them to focus on leading their business through the crisis, looking after their employees, suppliers and customers, in the knowledge that their investors expect them to take a long-term approach to running their business.

Throughout 2020 shareholders supported management teams and boards as far as possible to allow them to focus on the most business-critical issues to ensure their long-term sustainable future. Investment managers were still able exert pressure on companies, with key themes including climate change reporting and ethnic diversity. Analysis shows that in 2020, 136 FTSE All-Share companies were added to the IA's Public Register¹, which tracks significant shareholder dissent at Annual General Meetings or General Meetings.

The IA called on all listed companies to explain in their annual report the impact climate change will have on their business and how the company is managing risks and pursuing opportunities, in line with the four pillars of the Task Force on Climate-related Financial Disclosures (TCFD). The number of companies in the FTSE 100 reporting against at least some aspect of TCFD has more than doubled from 30 in 2019 to 77 in 2020. There however remains room for improvement in the comprehensiveness of reporting and quality of information on how the company plans to adapt or strengthen its business model and strategy to responds to climate risk.

It was disappointing that three-quarters of FTSE 100 companies failed to report the ethnic make-up of their boards in this year's AGM season and this lack of engagement and information is preventing investors from holding companies to account on their progress.

FTSE-listed companies have, however, made good progress on increasing the number of women on their boards reaching the 33% gender diversity target set by the Hampton-Alexander Review in September 2020. FTSE 350 boards with only one female director fell from 74 in 2018 to 16 in 2020, and there was only one all-male board in the FTSE 350 (from 152 in 2011). Investment managers will continue to keep up the pressure on those Boards still falling short.

¹ This is the number to the end of 2020, without withdrawn resolutions on the approval of the dividend (which were a feature of 2020 due to the start of pandemic). Including withdrawn resolutions on the approval of the dividend this number increases to 171.

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SHAREHOLDER PRIORITIES FOR 2021...

CLIMATE CHANGE

Climate change poses a significant risk to our way of life and will have a major impact on individuals, companies and financial markets. The risks associated with the impact of climate change could result in a significant loss of value in listed companies and this will ultimately impact on ordinary savers, whose pensions and savings are invested in these companies.

Climate related risks to companies range from the impact of extreme weather events on business operations and supply chains, to health implications, changes in consumer demand and employee behaviour.

As long-term investors in listed companies, investment managers' ability to create sustainable value on behalf of savers will be driven by how well listed companies identify, manage and mitigate the impact of climate change. This will be a significant focus in 2021 as the UK hosts the COP26 Summit.



'TCFD' explained

The Taskforce for Climate Related Financial Disclosures (TCFD) is a globally recognised framework for reporting the financial impacts of climate change. It was developed by the Financial Stability Board, an international body established by the G20 in 2009, to monitor the global financial system.

1 Climate change action

Investors expect all listed companies to report in line with TCFD. Investors will be looking for noticeable improvements to the transparency of climate-related metrics and targets. This will mean there is better information available on how companies plan to transition their business model, including in relation to capital management, which will be paramount to delivering on the UK's net zero ambitions by 2050.

2 Climate risk governance

Investors expect companies to clearly identify the directors or committees that are responsible for the oversight and management of the company's response to climate change. While investors maintain this is an issue for the whole board, naming specific individual board members or committees with responsibility for TCFD provides essential accountability and leadership on this critically important issue.

3 "Paris-alignment"

Directors should have clearly considered the relevance of climate change to their business as well as the transition risks associated with achieving the goals of the Paris agreement when preparing and signing off the company's accounts. Companies should be communicating to investors whether their business models are 'Paris-aligned'. For example, are their business activities consistent with achieving net zero emission by 2050 or earlier. This will help investors provide the necessary support and challenge to companies as they transition to greener and more sustainable business models.

SHAREHOLDER PRIORITIES FOR 2021...

DIVERSITY IN LEADERSHIP

Diversity in leadership and across the business is essential to building a company which can continue to adapt and deliver value for savers. Different people, from different backgrounds and with different experiences, bring different perspectives and approaches to the way an organisation is run.

Last year was a crucial year for this as it was the year in which FTSE 350 companies were expected to have at least 33% women on their boards, as set out by the Government-sponsored Hampton-Alexander Review. The IA has wholeheartedly supported this review from the start, which worked to increase the representation of women on boards and senior executive positions in companies. We were delighted the headline target of more than a third of board members across the FTSE 350 being women was hit. However, over four in 10 FTSE 350 companies failed to reach the target to individually ensure women make up 33% of their board.

Overall the 2020 AGM season showcased good progress in gender diversity. FTSE 350 boards with only one female director fell from 74 in 2018 to 16 in 2020, and there was only one all-male board in the FTSE 350 (from 152 in 2011). Investors will continue to keep the pressure up on companies failing to meet gender diversity targets.

Ethnic diversity, however, showed little progress by comparison. An independent review, known as the Parker Review, was setup in 2017 to consider how to improve the ethnic and cultural diversity of UK boards to better reflect their employee base and the communities they serve. While 11 companies have appointed directors from an ethnic minority background since the Parker Review, 37% of FTSE 100 companies still do not have any ethnic minority representation on their boards. The lack of disclosures and data remains a barrier to change and IVIS found that only 27% of companies in the FTSE 100 publicly disclosed their board's ethnic diversity during the year.

TRENDING
IN 2021

1 Ethnic diversity on boards

Significant progress is needed as investors expect UK plcs to take actions to improve the ethnic diversity of their boards this year. This should include greater consideration of how the board reflects their employee base as well as the consumers and communities they serve. Actions to identify and appoint directors to reach the Parker Review target of 'one by 21' (every FTSE 100 board should have at least one director from an ethnic minority background by 2021, and every FTSE 250 board by 2024) are needed urgently.

2 Ethnic diversity reporting

The lack of information on boards' ethnic diversity is preventing investors from holding companies to account on their progress. Better disclosures help investors as they look to identify those companies are furthest away from the targets and consider how best to support them to reach the targets. Companies' plan to reach the Parker Review target should be communicated to their investors. Shareholders would also benefit from disclosure of the ethnicity breakdown of the executive committee and their direct reports, aligned with the Change the Race Ratio initiative.

3 Gender diversity pipeline

For the first time women make up more than a third of all board members across the FTSE 350. However, companies should not view the end of the Hampton-Alexander Review cycle as an end to investor focus on diversity. Investors will keep up the pressure on those companies still falling short of the Hampton-Alexander targets.

A lot of work remains to be done on the gender diversity of the C suite and talent pipeline. Investors expect companies to disclose the gender composition of the executive committee and their direct reports. There is a danger the good progress made on boards will be lost without a strong pipeline of talent coming through at every level of the organisation.

SHAREHOLDER PRIORITIES FOR 2021...

EMPLOYEES, CUSTOMERS AND THE COMMUNITY

A company's prosperity is built by its employees, the communities around them, and the customers they serve. The COVID-19 pandemic has significantly

impacted companies and their stakeholders (such as its employees, customers, suppliers, the environment and communities in which it operates) and will continue to affect all companies in 2021.

Companies that manage these relationships well, identify and engage with their key stakeholders regularly. They understand their impact on communities and the environment and are then able to use this knowledge to build a stronger strategy as well as make better business decisions.





1 Stakeholder engagement

In 2020, companies had to report for the first time on how their directors take stakeholder interests into account. On the whole last year, companies managed to identify their key stakeholders and outline how they engage with them. Going forward, investors are looking for companies to provide more detail on how their board responded to stakeholder views and took account of these views in its decision-making process. The good relationship between a company and its key stakeholders is an important determinant of long-term success.

2 Employee voice

The Corporate Governance Code requires boards to disclose how they engage with their workforce to understand the views and concerns of employees – the ‘employee voice’. Boards must either appoint a director from the workforce, create a workforce advisory panel, designate a non-executive director to engage with employees, or make appropriate alternative arrangements. Investors expect companies to explain which option they have chosen and why it is the right one for the company and its employees.

The Corporate Governance Code explained

The UK Corporate Governance Code is a set of best practice principles for corporate governance in listed companies. The Financial Conduct Authority’s Listing Rules – the regulations for companies listed on UK stock exchanges – require premium and standard listed companies to apply the principles of the Code. Premium Listed companies comply with the UK’s highest standards of regulation and corporate governance, as a consequence they often enjoy a lower cost of capital through greater transparency and through building investor confidence.

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SHAREHOLDER PRIORITIES FOR 2021...

TRANSPARENCY AND ACCOUNTABILITY



In recent years there have been a number of high-profile company failures in listed and non-listed companies which have had serious implications for the people they employ, their suppliers, their customers and shareholders.

It is the responsibility of company boards and management to run the business. However, shareholders have a right to ask questions about the way the companies are managed and whether they are considering material risks to the long-term success of the company.

Shareholders rely on high quality audits to trust the information companies provide; transparency in the decisions companies make; and accountability mechanisms so executives will not profit from poor performance or short term gains via disproportionate remuneration packages.





1 Transparency on audit quality

Investors expect audit committees reports to explain the steps taken to ensure a high-quality audit. If there has been a tender for the company audit then the committee should explain why it recommended a particular auditor and how it would provide a better quality audit. It is the role of the audit committees every year to determine whether the auditor has provided a high-quality audit, questioned the information provided and exercised professional scepticism.

2 Pay for performance

Levels of pay that do not reflect corporate performance are a matter of deep concern to shareholders. Close attention will be given to companies paying executives bonuses which have been in receipt of taxpayer support (e.g. furlough) or as a result of windfall profits related to COVID-19. Executives should not be isolated from the impact of the pandemic that is inconsistent with the treatment of their workforce and wider community. Shareholders object to levels of pay that do not respect the core principles of paying no more than is necessary and they expect a clear link to sustainable long-term value creation. In order to incentivise an interest in the long-term health of the company after executives have left, shareholders expect executives to retain a proportion of their shareholding for at least two years. Remuneration policies should give remuneration committees the discretion to withhold a bonus ('malus') and recover sums already paid ('clawback') where payments were not warranted due to an executive's performance or conduct.

TRENDING
IN 2021

SHAREHOLDER PRIORITIES FOR 2021...

PAY

The impact of COVID-19 will be different for each and every company, whilst there are minimum expectations for every company, shareholders expect remuneration committees to take account of their individual circumstances particularly considering the impact on their stakeholders. Companies must sensitively balance the need to continue to incentivise executive performance at a time where management teams are being asked to demonstrate significant leadership and resilience while ensuring the executive experience is commensurate with that of shareholders, employees and other stakeholders.

The onset of the coronavirus pandemic meant compulsory gender pay gap reporting was suspended in 2020 but it is still of significant interest to investors. In these most difficult of circumstances, pay is an important part of incentivising the workforce and investors expect company boards to consider the pay and conditions of their wider workforce, including in relation to gender and ethnicity.





1 Explaining pay for all employees

Investors expect company remuneration committees to look at their wider workforce remuneration policies and how they have been impacted by the pandemic when deciding how much to pay chief executives and other highly paid employees. When compiling reporting obligations in relation to workforce pay, such as the Gender Pay Gap Reporting or executive to employee pay ratios, shareholders expect the company to fully explain these figures and why they are appropriate or state how the company intends to improve the situation. Though exceptionally suspended in 2020, Gender Pay Gap Reporting is well established and investors will be looking for improvements alongside details of how companies intend to close the gap.

2 Pension contributions

Pension contributions for executives should be aligned with pension contributions for the majority of the workforce. Investors question why board directors should be awarded much higher contributions in addition to their pay, bonus and incentive packages. New remuneration policies should state that any new executive director will have their pension contribution set in line with the majority of the workforce and pension contributions to existing directors should be brought in line with the rest of the workforce by the end of 2022.

3 Reporting pay ratios

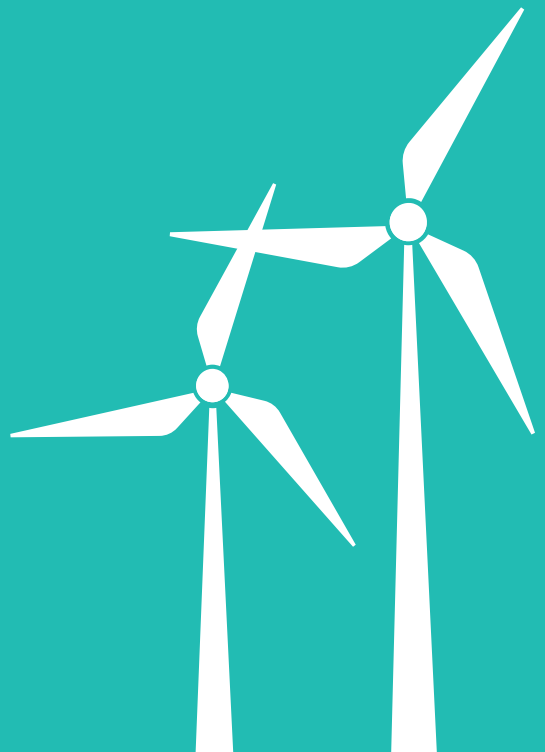
Companies were for the first time legally required to report against pay ratio reporting requirements in their 2020 Annual Reports. The IA has supported the introduction of pay ratios and requested that companies disclose them for a number of years. Investors will be scrutinising this year's pay ratios to see that positive progress has been made.

MORE WHERE THIS CAME FROM...

This report draws heavily on the position statements and guidance produced by the Investment Association and the Institutional Voting Information Service (IVIS). To find out more about the attitudes and expectations of IA members please visit [ivis.co.uk/guidelines](https://www.ivis.co.uk/guidelines)

The IA's Public Register of FTSE All-Share companies who have received significant shareholder opposition can be found at [theia.org/public-register](https://www.theia.org/public-register)

If you would like any further information on the issues outlined in this document please get in touch via: politics@theia.org





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