1 FEBRUARY 2017

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Annual reporting and AGMs: what's new for 2017 and beyond?

We're fast approaching the busiest time for 2017 reporting and, with that in mind, we thought we'd share with you our thoughts for navigating the 2017 reporting season successfully and give you a flavour of what to expect on corporate governance through 2017 and beyond. While the matters discussed primarily apply to listed companies, the increased focus on large privately held companies in the aftermath of the BHS collapse means some of what we outline below will be of interest to a wider audience.

2016 was a year of significant political and economic uncertainty. Added to that, corporate governance and corporate culture are once again squarely at the forefront of investors' minds and the increased focus on this is placing boards under significant scrutiny. This is as a consequence of some significant corporate failures during 2016 and also the Department of Business, Energy & Industrial Strategy's (**BEIS**) green paper on corporate governance (**Green Paper**). Whilst it's anticipated that the Green Paper could lead to significant changes in due course, there is, in fact, little by way of new regulation that will need to be considered when preparing the 2017 annual report and accounts. There are, however, a number of investor expectations and guidelines to consider.

What must be addressed for 2017?

Directors' remuneration policies

A number of listed companies will be required to put forward new remuneration policies for approval by shareholders this year. The Regulations requiring shareholder approval for remuneration policies have been in force since October 2013, with most companies passing their first resolution at their 2014 AGM. The maximum period for which approval can be given under the Regulations is three years, so most remuneration policies will be up for review this year.

Investor concern about the absence of a transparent link between executive pay and performance is on the rise. 2016 saw a significant number of occasions on which a large minority of shareholders voted against the

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recommendations of the board. Institutional investors have highlighted, through a number of reports and/or guidelines, what their expectations are for remuneration policies in 2017. The most contentious of these is the inclusion of a maximum cap on all elements of remuneration, including salary. At present, the remuneration policy must include maxima for each element of remuneration, but a single figure cash cap would be a very blunt approach. Other areas of focus are the structures of long-term incentives (see the Executive Remuneration Working Group Final **Report**), salary increases, how performance measure/targets are disclosed (see below), the disparity in contribution rates to the pensions of directors and those of employees and how companies exercise the discretion they reserve to themselves in relation to their remuneration policies.

Disclosure of performance targets

Since October 2013 companies have had to provide information on performance measures or targets when disclosing details of directors' remuneration in the annual remuneration report. This does not extend to information which, in the directors' opinion, is commercially sensitive in respect of the company. In that case, reasons for the omission must be included and an indication given of when (if at all) the information is to be reported to the members of the company.

The GC100 and Investor Group have provided detailed **guidance** on this point, suggesting that a decision to rely on the commercial sensitivity carve-out should not be taken lightly and only where there are company-specific circumstances that lead the directors to positively form the opinion that the performance measure or target concerned is commercially sensitive. In addition, in October 2016, the Investment Association (**IA**) published a **letter** indicating that it will "Red Top" reports where targets are not disclosed or the company has not made a commitment to disclose the target range in future, and will "Amber Top" reports where it considers the disclosure of targets to be inadequate.

The Green Paper includes consultation on whether the requirement to disclose performance targets needs to be strengthened.

Given the above, there is likely to be a strong focus on the retrospective disclosure of performance targets and commitments for future disclosures this year.

BREXIT disclosures

Companies will need to consider what disclosures are appropriate relating to the likely impact of the BREXIT vote and of BREXIT itself on their businesses in the long term in their annual reports. The Financial Reporting Council (**FRC**) raised this in both its **half-yearly reminder** to investors in July 2016 and its **year end advice letter** in October 2016. We have already seen some companies include BREXIT as a principal risk factor in their strategic reports.

Slavery and human trafficking statements

For those companies caught by the requirements of the Modern Slavery Act 2015 (**MSA**) (commercial organisations which carry on business in the UK supplying goods or services with a total turnover of £35m), there is now a requirement to publish a modern slavery statement which discloses either the steps taken during the financial year to ensure slavery and human trafficking do not take place in its supply chain or its business or that the company has taken no such steps. This statement must be made in a prominent place on a company's website. Although not an MSA requirement, we've noted that

some companies are also choosing to include modern slavery statements together with details of their processes and procedures in their strategic reports.

For companies with a 31 December year end which meet the MSA criteria, 2017 will be the first financial year this statement is required. Although no time limit is set in the MSA for publication of the statement, Home Office **guidance** encourages this to be done no later than six months after the financial year end – June 2017 for 31 December year end companies.

Disapplication of pre-emption rights

Companies listed on the main market of the London Stock Exchange wishing to disapply pre-emption rights should follow the template resolutions issued by The Pre-Emption Group (**PEG**). PEG issued a revised Statement of Principles to reflect market changes in March 2015. Both the Pensions and Lifetime Savings Association and the IA support the Statement of Principles. The **template** recommends two resolutions:

- the first resolution requests a five per cent disapplication to be used on an unrestricted basis
- the second resolution, to be used when appropriate, requests authority to disapply in cases where boards consider the use to be for the purposes of an acquisition or specified capital investment in accordance with the Statement of Principles. PEG expects that the circumstances leading to the request to include such a resolution and the consultation process undertaken would be disclosed in the relevant placing announcement.

It is also worth noting that the IA and other investor bodies now consider it acceptable to take authority to allot up to two thirds of existing issued share capital provided that the excess over one-third should only be used for fully pre-emptive rights issues. An increasing number of companies have been taking advantage of this relaxation.

Audit committee competence requirements

Pursuant to changes made to the UK Corporate Governance Code (the **Code**) which apply to companies with a financial year end starting on or after 17 June 2016, the audit committee as a whole is now required to have competence relevant to the sector in which the company operates. This requirement is also reflected in the FRC's **Guidance on Audit Committees**. Audit committee terms of reference should be updated as appropriate.

Share buy backs

The EU Market Abuse Regulation came into force in the UK on 3 July 2016, so AGM resolutions and notes need to be reviewed and all references to the EU Buyback and Stabilisation Regulation 2003 should be removed.

In addition, the Pensions and Investments Research Consultants (**PIRC**) introduced a new policy in relation to buy backs in its 2016 shareholder voting guidelines. PIRC will now recommend voting against a general authority to buy back shares unless the board has made a "clear, cogent and compelling case of how the authority will benefit long-term shareholders.

In taking this approach, PIRC appears to be saying that the relatively standard approach of taking the authority for possible future use and explaining that it will only be used if it is considered necessary to increase

earnings per share, or is otherwise in the best interests of the company and its shareholders, is no longer acceptable. Companies with significant public authority investors (which PIRC represents) are recommended to provide a more specific explanation for seeking the authority although PIRC's guidelines do not prevent share buy backs per se. It is worth noting that other investor bodies do not appear to have the same concerns.

Reporting on gender balance in FTSE leadership

In November 2016 the Hampton - Alexander Review published its **report** on improving gender balance in the leadership of FTSE 350 companies. In the context of annual reporting, it recommends that all FTSE 350 companies should voluntarily publish details of the number of women on the executive committees and in the direct reports to the executive committees in the annual report and accounts and/or on websites. At this stage, any disclosure is entirely voluntary but the report also suggests that the FRC should amend the Code to require all FTSE 350 companies to disclose the gender balance on the executive committees and amongst persons who directly report to the executive committees in their annual report.

Other areas for consideration in 2017 reporting

Viability statements

These statements by listed companies (required for the first time in 2016) are designed to strengthen focus on the company's prospects in the longer term. Directors must decide the period against which prospects should be considered and must explain why they consider that period to be appropriate. In 2016, the majority of companies chose either a three or five year review period.

The review period has been the subject of much debate. The FRC has stated in guidance that the period should be significantly longer than 12 months unless there are exceptional circumstances and that companies should consider what period is appropriate and provide clear disclosure of why the period was chosen. These recommendations have been made to made to ensure that the relevant disclosure does not become boilerplate. In a similar vein, the IA has issued **guidance** suggesting that directors should consider longer time frames than between 3 to 5 years. It also suggests that directors should be clear why the chosen timeframe has been selected and consider differentiating between short, medium and long term timeframes for prospects and viability. It seems likely, therefore, that viability statement will continue to be an area of particular scrutiny throughout 2017.

Corporate culture

Corporate culture and the role of boards will remain a "hot topic" for companies throughout 2017. In July 2016, the FRC published its report on "**Corporate Culture and the Role of the Board**". This report, designed to stimulate thinking in the area, highlights the need for companies to constantly focus on their corporate culture as a means of delivering long-term success. Throughout 2017, the FRC will be monitoring reporting on culture by companies and investors. Boards may therefore wish to consider how best to reflect the company's culture/purpose in their annual reporting so that stakeholders can draw meaningful links between corporate culture, strategy and the business model. This is not an easy area and will need some careful consideration; in particular, providing a narrative that properly describes how culture delivers success in all its forms is challenging.

Holding AGMs electronically – the way of the future?

2016 saw the first electronic AGM held by a UK listed company, Jimmy Choo, with the assistance of Equiniti. Participation in the AGM was enabled through the use of a secure App which enabled shareholders to participate in the AGM from wherever they were based, avoiding the costs of travel to the AGM and, of course, the costs to Jimmy Choo of hiring a venue. By all accounts, the AGM was better attended than previously held physical meetings. If companies are thinking of this, their registrars will be able to help with the processes and required technology. Companies are also likely to have to amend their articles of association by way of special resolution to allow for electronic AGMs.

What we know is coming for 2018 reporting

Gender Pay Gap Reporting Regulations

These regulations are expected to come into effect on 6 April 2017 and will require private sector employers with more than 250 employees to publish the difference in mean and median gross hourly pay and bonus pay between male and female employees, the proportion of male and female employees who receive bonuses and the number of male and female employees in each quartile of its overall pay range.

The information is required to be published on the employer's website and on a government sponsored website. Although there is no requirement to include this information in the annual report, it is expected that a number of companies will do so. The first gender pay gap reports must be published on or before 4 April 2018, based on the previous 12 months. **Draft guidance** has recently been published by ACAS and the Government Equalities Office which sets out how to report on the gender pay gap in compliance with the legislation.

Non-financial reporting requirements

New **regulations** in relation to non-financial reporting are expected to apply to financial years starting on or after 1 January 2017. UK quoted companies are already required to include in the strategic report environmental, social and governance information, including as regards human rights issues, to the extent required to understand the business of the company. The new regulations will extend this requirement to all large traded companies i.e. those companies with securities admitted to any regulated market and to all banks, authorised insurance companies and building societies (subject to limited exceptions). They will also extend the information required to include information on anti-corruption and anti-bribery matters. Where companies do not have policies, a clear explanation must be provided as to why not. While these disclosure requirements are unlikely to raise significant concerns for UK quoted companies (such companies will simply need to expand their existing strategic report disclosures), those companies which will be subject to these requirements for the first time would be advised to start considering sooner, rather than later, what form their disclosures might take.

Payment Reporting Regulations

From 6 April 2017, new regulations require large companies and LLPs to publish prominently specified information about their payment of suppliers, including the average time it takes to pay suppliers on to a government website which must be updated every 6 months. Although companies are not required to include details in their annual reports, it is expected that some companies will do so. BEIS published its **guidance** on the duty to report on payment practices and performance yesterday.

Changes on the horizon

Government Green Paper

The **Green Paper** on corporate governance reform was published in November with the aim of considering what further changes might be appropriate for the corporate governance regime in the UK. The Green Paper focuses on three specific areas: executive pay, strengthening the wider stakeholder voice and corporate governance in large privately-held businesses. For more details please see the earlier **article** we wrote on the Green Paper.

Responses to the Green Paper are invited by 17 February 2017. Meanwhile the BEIS Parliamentary Committee will report at some stage on its own, separate wide-ranging inquiry into corporate governance, covering many of the same areas.

UK Corporate Governance Code

The FRC has stated that developing and implementing the actions which may result from the conclusions of the review of corporate governance reform, initiated by the Green Paper, will require potentially significant changes to the Code. One of the FRC's stated priorities for 2017/18 will be to update the Code and associated guidance to reflect any actions identified following the review. The FRC has also put forward its case for increased enforcement powers in its response to BEIS on the Green Paper. The FRC anticipates consulting on appropriate changes during 2017
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Ethnic diversity on boards

Diversity on boards will continue to be a hot topic in 2017. In addition to the progress on gender diversity (see above), there is increasing focus on ethnic diversity.

The Parker Review **consultation report** on ethnic diversity was issued in November last year. It was initiated in late 2015 to explore why there is an absence of ethnic diversity on boards, to suggest ways of increasing ethnic diversity and to encourage businesses to adopt approaches which could be effective in increasing ethnic diversity. In the context of annual reporting the review includes a suggestion that the annual report should include a description of the board's policy on diversity. This should include a description of the company's efforts to increase, among other things, ethnic diversity within its organisation, including at board level. Companies that do not meet board composition recommendations on ethnic diversity by the relevant date should disclose in their annual report why they have not been able to achieve compliance.

Comments on the consultation version of the report are requested by 28 February 2017, after which a report containing the final recommendations and findings of the Review will be published.

If you require any help or advice with any of the matters mentioned above please get in touch with your usual Hogan Lovells contact or one of the listed Contacts.

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