

MODERNISING THE UK AGM: Empowering Companies and Investors

UK Annual General Meeting (“AGM”) choreography in its current form in theory provides companies with an opportunity to engage directly with all shareholders – retail and institutional, activist and crusader. In reality, however, the longstanding accepted AGM structure is being destabilized to the detriment of both companies and investors.

Due to necessary outsourcing of voting analysis in many non-contested (and even contested) circumstances, the influence of proxy advisory firms in the AGM process can result in naïve voting decisions or voting by omission that fails fairly to take into consideration a company’s individual circumstances or reflect genuine debate about apparently contentious issues. At best, the delegation of AGM voting is a divide in the relationship between investors and boards; at worst, it undermines trust, prevents a functional relationship and strips the meeting of its intended purpose as a genuine forum for engagement.

In this system, investors forgo bespoke analysis and engagement in exchange for voting efficiency. Practically speaking, this is a necessary trade off given the volume of agendas in play during the AGM season. Unfortunately for Executive and Non-Executive Directors alike, the effective delegation of voting decisions to third party agencies that have no “skin in the game” or open relationship with the company can fuel negative headlines in the run up to their AGM. This is compounded by the tradition of combining the AGM with voting, with the result that there is little to no time or ability to explain or to make reasonable adjustments that demonstrate good governance.

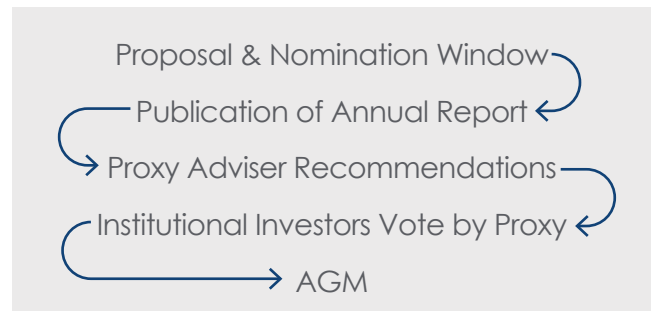
While the argument may appear counterintuitive on its face, companies and investors might be better served by a different approach to the AGM and related voting. By separating the voting process and the AGM by a suitable period of days or weeks, boards would have the flexibility to adapt proposals after taking into account the debate at the AGM, and to be responsive to shareholder concerns. It would also mean that boards would have more substantive engagement with investors in advance of and, critically, at the AGM itself.

This would allow boards and investors to engage in an open and transparent way, resulting in better overall board/investor engagement and develop solutions that are right for a specific business and its constituents. It would also soften the influence of the proxy agencies, forcing them to respond after the meeting

to updated proposals and debate. Their initial reports would instead have to focus on the key questions to ask or which issues need clarifying, ahead of finalising recommendations that take into account the debate between the company and its investors.

The key question therefore is how to make this work in practice.

The Existing Process:



Despite its anodyne appearance, many of the stages in this process introduce the potential for destabilizing forces to disrupt the smooth functioning of the meeting and voting process. This is particularly acute at the “recommendations” stage, where proxy advisers such as Institutional Shareholder Services (ISS), Glass Lewis, IVIS, PIRC, etc., make their voting recommendations to their respective institutional investor clients. Negative recommendations often result in negative headlines at a very late stage in the process, exposing directors to criticism on matters when it is too late to have a timely consultation with investors and respond to the recommendations.

While many proxy recommendations and institutional investor votes come back as the company expects and the AGM takes place without difficulty, there is clear evidence that there is an increase in boards being caught off-guard by negative vote recommendations and the related quantum of votes against or withheld from company proposed resolutions. Within the confines of the current process, boards have limited options in how they are able to address these issues before the following year’s AGM, often leading to

constrained decision-making and strained investor relations for a sustained period of time. The integrity of the voting process is also vulnerable when combined with the debate in meeting given the highly technical procedures that must be observed to achieve a valid vote at the meeting.

This dynamic is due in part to companies setting the AGM agenda before the market has had the chance to consider the annual report, and particularly the remuneration reporting, believing either that there is little proposed that should pique controversy or through failure to anticipate the true temperature of “hot button” issues. Oftentimes, this is the result of an anaemic approach to investor engagement on governance matters in the quieter periods for investors before the AGM agenda is set.

Companies now rightly identify remuneration as a potential pain point following several years of investor “revolts” but the annually occurring issues (i.e., excluding M&A, CEO succession, activist director nomination, etc.) that concern investors are now broader than just executive pay. Matters such as director over-boarding, board diversity (or lack thereof), and burgeoning ESG issues are all becoming areas of potential contention leading to anything from quiet votes “against” both specific directors and individual proposals to hotly contested AGMs where boards have little opportunity in the current structure to change.

A New Approach: Better for Boards, Better for Investors

In many ways this process has contributed to many of the breakdowns in governance and company / investor relations we see today. The entire ecosystem of participants would benefit from change. While voluntary changes by individual companies would lead to incremental improvements over time, companies may be understandably reluctant to be first movers.

Wide adoption and institutionalisation in a consistent manner may require the statutory force of additional modifications to both the Companies Act and the Corporate Governance Code, but the proposed changes in this paper are not so radical that individual companies could not set the trend in motion and better develop a non-statutory process that better meets market requirements.

Our proposal would enable companies to pre-empt opposition and avoid the need for post meeting consultation and reporting in response to opposition voting as per Provision 4 of the 2018 UK Corporate Governance Code (the “Code”). This would be achieved by ensuring that the overall meeting and

voting process creates the conditions for companies to engage robustly with, and understand, investor concerns ahead of the vote rather than waiting for investors’ votes cast against a resolution to spur explanation and action retroactively.

Specifically, the key voting process on principal resolutions should be separated from the theatre of the meeting and held a suitable period of time after the debating meeting takes place¹. Boards, knowing the process presents opportunities for effective discussion and challenge, will naturally seek ways to engage more proactively with investors in order to understand their views. Resolutions that can be amended after discussion and prior to final voting will be more open to debate, thereby avoiding the need to ‘second guess’ the opinions of others on any potentially contentious business. Shareholders will have full opportunity in advance of, and during, the meeting at which proposals are debated to consider a board’s position on the resolutions without the immediate pressure to cast a vote before or at the meeting. This, in turn, would soften the influence of proxy advisers on the process by increasing the opportunities for direct dialogue between a board and investors about material matters.

What should this entail in practice?

The fundamentals of the voting process would not change. This needs to be done in an organised and methodical way and the ability to handle proxies and use electronic voting technology where possible will encourage a strong turnout and ensure the results are verifiable and have integrity. The obligation to hold an AGM would not change. The need to publish proxy papers at least 21 clear days prior to the AGM would not change. Record dates would also remain in force to avoid opportunists capitalising on dislocations that only become apparent in the context of the meeting.

What would change fundamentally is the nature of the meeting itself. Ideally, preliminary resolutions would be published with the notice of the meeting, then proxy advisers could provide recommendations before the meeting to support debate. This would create the conditions for a discussion before and during the meeting, after which the company would have a suitable window of time to issue finalised resolutions incorporating whatever amendment is necessary after taking debate and commentary into account and then solicit the actual votes. Proxy advisers, if they wanted or were needed to by investors, could then publish their final recommendations and investors can choose to follow them if expedient. But in this process investors will be afforded more opportunities to make informed voting decisions in specific cases, taking advantage of a longer and better structured engagement with the company if needed.

¹ We have referenced ‘meeting’ or ‘debating meeting’ for ‘AGM’ here and elsewhere to leave scope for the voting procedure to be conducted consistent with company law at an ‘annual general meeting’ but without debate which would have preceded that at a meeting.

The proposal to separate debate from the actual vote fits with the existing meeting regime for UK corporates. What is novel is the presumption of separation of the meeting and debate from the actual vote. Should proposals prove not to be contentious, the vote could be addressed after the meeting under currently available procedures where the vote takes place at a subsequent designated time (a deferred poll vote). For contentious issues that call for material change to resolutions, current 'adjournment' procedure is sufficiently flexible to implement the broad concept proposed in this paper – separate debate from the vote, allow time for reflection, engagement, alteration and re-presentation of revised resolutions on which members can vote.

The proposal to separate debate from the final vote is key to putting power back in the hands of boards and investors. For proxy advisors to remain relevant, they must publish recommendations that are responsive to the discussion between the board and shareholders rather than being hidebound to a set of "one size fits all" policies. After all, this approach should be at the heart of a 'comply or explain' regime.

While we are not naïve enough to believe that this process will ameliorate all disagreement – there will continue to be cases where company and investor views remain at variance or the position adopted by proxy advisers is rigid in the face of understanding between a company and its investors – the grounds of disagreement will be well understood while the opportunity to adapt proposals will better serve all parties than ex post facto explanation and correction that addresses unsatisfactory voting results retrospectively.

Ultimately the scope for boards fully to engage with their investors and, in suitable circumstances, adapt in the face of sustained opposition will avoid the unfair impression of proposals that lingers around significant adverse voting addressed only after the fact. It will allow, in the words of the Introduction to the Code, for investors to have due regard to the company's individual circumstances, exercise their right challenge explanations if they are unconvincing but not in a mechanistic way, whilst at the same time giving companies sufficient time to respond to enquiries about corporate governance.

Fundamentally, the proposed process creates a forum for investors to engage with a board before positions become fixed and enables the board to retain the flexibility to address investor concerns in a collaborative rather than adversarial way. While some boards may be reluctant for the fear of challenge, the reality is that visible stewardship through engagement is a corollary to strong governance and empowers both management and the board. This is governance in action.

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