GOVERNANCE

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European 2019 AGM season

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Daniele Vitale

How to leave a lasting legacy?

'The value of a well-designed succession plan is indisputable: firms which fail to provide a clear framework for succession after the passing of a founder often experience severe difficulties. However, merely having the vision to design a succession plan does not guarantee success. The further dimension to take into account is human nature.'

Yin-Hua Yeh

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European 2019 AGM season

Daniele Vitale looks at key considerations for the forthcoming AGM season across Europe.

The corporate governance community across the UK and continental Europe is bracing for the arrival of the 2019 AGM season and is busy undertaking as much preparatory and engagement work as possible to smooth the way. Following an intense 2018 AGM season, which in many markets was characterised by an increased focus on director elections and continued pressure on executive remuneration, early indications are that the 2019 season will bring notable upheavals in the German and Dutch markets (with major transitions underway on share capital dilution and the expected introduction of annual remuneration votes), while the rest of Europe portends continued pressure on the two traditional areas of focus: boards and remuneration. Across Europe, investors are also actively on the lookout for better metrics based on which to hold external auditors to account, but development on this front has moved slowly so far. What is certain is that the pressures that institutional investors are subject to in terms of AGM voting (from their customers, their shareholders, the media and the regulators) will continue to keep their investee companies (and their advisers) on their toes across Europe.

In order to provide a comprehensive perspective, the Georgeson European 2018 AGM Season Review focuses on a number of key metrics. The starting point is to look at the number of failed resolutions and the proportion of resolutions and AGMs that received more than 10% negative votes. Simply looking at the number of failed resolutions it appears clear that among the major European markets the Netherlands and the UK have the least contentious AGMs while France has the most contentious (the elevated Swiss number can be ignored because it is all down to the Sika situation which has since been resolved). This is certainly in line with our experience.

To a certain extent this depends on the relationship which companies have with the local investor community (which tends to influence the global proxy advisers) as well as the willingness of companies to adapt to shareholder demands. Another important factor is the kinds of resolutions that are put to the vote (for example, in the Netherlands and Germany, there is still no annual vote on remuneration, although this is now being introduced by the EU; and directors are not re-elected annually).

One of the most notable findings in our analysis is how much more willing investors are becoming in opposing board members directly when they consider that there have been corporate governance failings. The number of director election proposals at large cap companies that received at least 10% opposition has doubled since 2016 in the UK and France (increases of 128% and 95% respectively). Increased investor concern was also evident in Germany, where there was a 114% increase in the number of contested proposals relating to the discharge of the management and supervisory boards since last year. In Spain, director elections continue to be the most contested resolution type, representing 41% of the contested proposals brought forward. The focus on boards also extended to other areas: in France there was increasing investor opposition to combined Chairman/CEO mandates. Over 70% of Chairman/CEO re-elections (across the CAC40 and Next20) received a higher level of dissent in 2018 compared to their previous elections.

At the same time, our review shows that executive remuneration remains a significant area of focus for many investors across Europe, with large cap companies continuing to suffer intense levels of scrutiny. Remuneration report resolutions that received at least 10% opposition increased by 43% in Italy compared to 2017, while in the FTSE 100 the increase was 39% (while for resolutions with at least 20% opposition the increase was 63%). In Germany 56% of remuneration system votes were contested by at least 10%, while in Switzerland 65% of remuneration report resolutions were contested. In the Netherlands, remuneration was a prominent theme, with 22% of remuneration policy votes receiving at least 10% opposition: a 46% increase over 2017. Additionally, public debate over remuneration was so intense that two companies decided to withdraw remuneration-related resolutions.

Director elections

As noted, boards of directors are increasingly facing a shareholder base which is willing to hold them personally accountable when they feel that their concerns are not being addressed. While the traditional areas of focus, such as director independence and over-boarding, continue to be the main risk factors for board re-elections, there are a host of other themes that investors are beginning to pay attention to, and – more importantly – are increasingly willing to use as reasons to vote against a candidate.

Over the past few years the focus on committee membership and independence has clearly increased. In some markets, such as the UK, where the Corporate Governance Code has long provided guidance on this aspect the impact has been limited – but in others, where there is less local guidance, it is clear that investors and proxy advisers are becoming more willing to question committee composition (with a notable tightening of ISS guidelines on audit committees for 2019).

Feature

Interestingly, Swiss regulations, which require a separate vote on remuneration committee members, even allow investors to support a candidate for board membership but oppose their inclusion on the remuneration committee.

Another area of investor concern is the length of director terms. Again, in markets like Switzerland and the UK, where directors are voted on annually, this is not an issue. But in countries like Germany, where directors can be elected for five-year terms, investors have started to notice how much more limited their influence is to address issues as they arise, and some investors (such as State Street Global Advisors) have stated explicitly that this will be an area of focus for them in 2019. This is also likely part of the reason why at German AGMs there is a higher focus on the discharge votes on the Supervisory and Management Boards, which are put forward annually.

Finally, there has been a dramatic increase in the attention paid to board diversity. This is most evident in the area of gender diversity, where some markets have imposed quotas and investors have explicitly threatened to vote against directors unless improvements are being undertaken (for now, sanctions have tended to apply only to companies that have no female board members at all). However, there have also been discussions about ethnic diversity (but it has been noted how much more difficult investors are finding it to obtain relevant and reliable data). There is also an increasing focus on board skills, with Glass Lewis, for example, starting to include a skills matrix in their AGM reports. However, it should be noted that, so far, a perceived skills deficit has typically only influenced investor votes negatively in contested (activist) situations.

Executive remuneration

While we expect executive remuneration to continue to rank highly on the investor agenda across Europe, it will be a particularly big theme in Germany and the Netherlands during the 2019 and 2020 AGM seasons. That is because these are the two last major European markets which do not currently have an annual vote on remuneration – and will therefore undergo a significant change once the revised EU Shareholder Rights Directive is transposed into national law this year. While it is true that in both markets companies must obtain approval for their remuneration policy, this is typically only done when a change in policy is envisaged. Therefore there are quite a number of companies that have not had a shareholder vote on remuneration of any kind in many years. Our expectation is that this change will require significant adjustments on the part of companies as investors – who largely ignore remuneration practices when no vote is involved – will discover practices that they have long stopped tolerating in other markets where all companies put their remuneration up for some sort of annual vote.

A debate which will continue to develop across Europe with regard to executive remuneration is the question of what form variable pay should take. Some investors, notably Norges Bank, have advocated replacing the traditional and prevalent model of long-term incentive plans (share awards whose vesting is subject to a 3- to 5-year performance period and are at risk of forfeiture), with restricted stock awards (smaller share awards with longer time restrictions but no performance conditions attached). This continues to be a minority opinion among leading institutional investors, who tend to prefer long-term incentives that are subject to stringent and transparent performance conditions. However, some companies have succeeded in making the case that due to their particular circumstances the restricted share award model would be more appropriate for them (one example of this is Weir Group in the UK, which obtained 92% support for this change in 2018, following a previous failed attempt in 2016).

External auditors

Shareholder approval of external auditors is notable for its virtual absence from our review of the 2018 AGM season. We focus on resolutions that have received a certain level of opposition and this absence underlines how rarely the appointment of the external audit firm is challenged by investors. However, while there has been widespread debate about the effectiveness of the audit market, particularly in the UK, the institutional investors are also clearly on the lookout for better and more stringent metrics to use in assessing these resolutions. Currently the main consideration is the proportion of non-audit to audit fees – however, for 2019 ISS has, for example, introduced a new guideline under which they will note the lead audit partners who have been linked with significant auditing controversies at other companies. We expect that, under pressure from regulators, institutional investors will make attempts to show that they are keeping this area under more effective and stringent review.

Capital increases

Over the past several years there has been a convergence in the level of dilution that investors are prepared to accept for share capital authorities without pre-emptive rights, moving towards a consensus maximum of 10%. In the UK, which had applied a maximum level of 5% since the 1980s, the accepted level was increased to 10%, while in France the accepted level has gradually been reduced from 20% to 10%. Individual investors who had long accepted the higher level of dilution in other European markets also began to tighten their policies and, as of 2019, ISS has adapted their guidelines to reflect this shift.

Once again, it seems likely that this general change in attitude will be most noticeable in Germany and the Netherlands,

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where notably companies have continued to request authorities without pre-emptive rights that were capped at 20% dilution. Therefore going forward we expect to see an increased focus on companies that do not adapt their resolutions to the emerging consensus of limiting potential dilution without pre-emptive rights to 10%.

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For further information, you can find the Georgeson 2018 AGM Season Review here: https://www.georgeson.com/uk/2018-season-review.

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