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Doing less and achieving more

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Ian White

A code of conduct for directors

'The absence of a code of conduct for UK board members is perhaps surprising, given the crucial role that directors play as leaders, role models and decision-makers in society. Appropriate director behaviour is as pivotal to the legitimacy and performance of business as that of any other professional role (perhaps more so).'

Roger Barker

Content

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News

Running effective general meetings

The Financial Reporting Council (FRC) has released, for the first time, specific guidance for listed companies to enhance effective shareholder participation when planning and conducting general meetings. The Guidance is written with Annual General Meetings (AGMs) as its focus, but uses the term ‘general meetings’ (GMs) to cover all forms of shareholder meetings. With input from a wide range of stakeholders, it gives practical advice to help companies ensure that their GMs are well-run constructive forums for effective engagement.

Before the GM

Information disseminated prior to the GM must provide clear instructions on how to attend and participate, in order to facilitate effective shareholder engagement. Appropriate means of communication should be used to update all shareholders, eg a dedicated area on the company website. Clear and timely instructions for attending and participating in the meeting should be provided in advance to shareholders, including access to the meeting, asking questions and voting (whether physically, electronically or by proxy). Shareholders who are yet to opt-in to receive electronic communications should be informed of the process for doing so.

Whether meetings are physical, hybrid or virtual (should the legal position be clarified), shareholders should, as far as practicable, be able to engage in the business of the meeting. Where registration and verification are required to access the GM, shareholders should be provided with the relevant information through their registered/elected method of communication in advance. Details of how and when to submit questions prior to the GM should also be given well in advance, with a clear timeframe explaining when and where questions should be sent and how they will be answered. Companies could consider answering questions ahead of the GM where practicable, so that responses can inform shareholders’ voting decisions.

During the GM

The board should provide an update on investor and stakeholder engagement and matters raised by stakeholder groups that are considered by the board to materially affect the company’s strategy, performance and culture. The board should also take the opportunity to explain how matters raised have been taken into account or influenced decision-making.

Questions

Companies should seek the broadest access to, and participation in, GMs by a diverse range of shareholders. Whether attending virtually or in person, shareholders should have the opportunity to raise questions pertinent to the meeting agenda. The Chair should ensure that questions are taken from all available channels for submitting questions and consideration should be given to opening Q & As for written/electronic questions from the start of the meeting. The Chair of the meeting (who may or may not be the board Chair) should also ensure that, so far as practicable, board members attend the meeting (virtually or physically) to respond to questions. The Chair should direct questions to those with the appropriate expertise.

‘Companies should seek the broadest access to, and participation in, GMs by a diverse range of shareholders.’

Voting

Shareholders should be able to cast their vote in real-time or submit a voting instruction in advance via the appointment of a proxy, depending on the meeting format. Appropriate technology should be used to ensure that shareholders have the ability to appoint proxies and send instructions to proxies prior to the meeting. Where the technology allows, shareholders should be informed that votes can be changed during the meeting.

Consideration should be given to holding a live webcast (or audiocast) if the meeting is a physical-only meeting to encourage engagement with shareholders not able to attend.

After the GM

Companies should be as transparent as possible with shareholders in relation to matters discussed and raised by shareholders at the GM. Efforts should be made to gather feedback from the GM and analyse any trends in views. Where 20% or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take. Shareholders should be able to follow up on any answer given to a question asked at the GM via a specific email address. If the meeting is recorded all shareholders should be notified, in advance, where, when and for how long the recording will be available.

Continuous engagement

Effective and transparent shareholder engagement should not be limited to an annual event. Opportunities to update shareholders on company matters should be offered throughout the year, with an emphasis on ensuring all shareholders have access to similar information. Recognising that all companies are different, the Guidance offers flexibility. Companies will need to take different approaches and use different technologies and methods depending on their circumstances.

For the full Guidance go to: https://bit.ly/3So1LGv

International

Climate reporting in ASEAN companies

Seventy per cent of the top 600 ASEAN companies have published sustainability reports with disclosures relating to climate, according to landmark research from Global Reporting Initiative (GRI) and the National University of Singapore (NUS) Business School. The Report, *Climate Reporting in ASEAN: State of Corporate Practices*, sheds light on how companies in the Association of Southeast Asian Nations (ASEAN) are addressing their obligations for climate-related reporting.

Reporting
There was a wide variance in the depth of reporting across sampled companies in the six countries, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam. Countries with mandatory sustainability reporting fared better. Companies in general were better at reporting issues relating to materiality, targets and risks and opportunities, than reporting about strategy. While most companies are aware of climate-related risks, they are less adept at linking those risks to the long-term impact on their organisation.

The six countries used various reporting frameworks in their climate-related reporting. The GRI Standards and Sustainable Development Goals frameworks were the most widely used across all the countries. The Philippines and Thailand demonstrated a higher uptake, though still low, of the Taskforce on Climate-related Financial Disclosures.

Materiality
While most companies did not explicitly detail climate change as a material concern, 84% identified material topics related to climate change, such as greenhouse gas (GHG) emissions, energy and air quality. Companies in Thailand ranked highest in identifying climate change as a material concern; those in Malaysia ranked highest in identifying climate change-related material concerns, such as GHG emissions and energy; and Thailand companies ranked highest again in determining the significance of climate-related risk in relation to other risks.

Risks and opportunities

Climate risks fell into four key areas:

1. physical – extreme weather conditions as well as the implications of rising temperatures on the workforce were cited as causes for concern;
2. regulatory – companies are concerned about fines for failure to adhere to upcoming climate regulations;
3. transition – the transition into a greener economy and the potential for rising operating costs is causing concern; and
4. reputation – companies engaged in polluting businesses as well as those dependent on pollutants for their business and those with suppliers that havepoor ESG records expressed concern, as did some businesses not directly affected by climate risks.

Climate opportunities include partnerships with stakeholders such as employees, customers and the community to encourage eco-friendly behaviours. There are also opportunities for businesses looking at reducing energy costs, switching to renewable technologies, finding new uses for by-products in manufacturing processes or developing wider ranges of sustainable products.

Governance
Sixty-eight per cent of companies have assigned climate-related responsibilities to management-level positions or committees. These committees tend to oversee sustainability of the organisation and report to the board. There is growing interest among regulators and investors in the link between executive compensation and sustainability performance. However, only 8% of ASEAN countries disclose this link. Companies in Vietnam and the Philippines do not link remuneration to sustainability performance.

Strategy
Most companies discussed their long-term strategy time horizon (more than five years) but not their short-term (less than two years) and medium-term (two to five years) strategies. Of the long-term strategies cited, reduction of GHG emissions and carbon neutrality goals were the most common. There is a rise in the number of companies adopting a systematic approach to developing their climate strategies, particularly related to energy or carbon reduction.

Targets
Most companies included GHG emissions and energy consumption metrics over a few years to allow for trend analysis. Companies were also active in their discussion of targets. However, 46% did not discuss how they would assess progress against targets using KPIs. While most companies have set measurable targets by detailing the percentage of reduction and comparison to baseline year, some companies set vague targets such as reducing energy and water usage and noise pollution across all their projects. Most companies set targets to reduce GHG intensity rather than GHG emission; only 91 have set targets related to increasing low-carbon energy consumption; and only 40 have set targets to achieve net-zero carbon emissions.

Performance
In terms of how companies use performance data to manage climate change, 62% disclosed GHG emissions and non-renewable fuel consumption; however, disclosure of renewables was not as widespread. GHG emissions data were often incomplete: only 80 companies reported their scope 1 emissions disaggregated by source type, only 43 reported their scope 1 emissions disaggregated by facility and only 75 reported their scope 2 emissions disaggregated by source type.

For the full Report go to: https://bit.ly/3A3eFTz

Global News

Stewardship practices

The Financial Reporting Council (FRC) commissioned an independent project to better understand the current stewardship practices of asset managers and asset owners in areas covered by the UK Stewardship Code 2020. The project also assessed the impact of the revised Code on stewardship practices. Overall, there was strong evidence of material changes of practice, notably in governance and resourcing, engagement, collaboration and escalation and monitoring and reporting.

Governance and resourcing
All organisations reviewed identified some form of organisational restructuring to better integrate stewardship within their investment decision-making. Typically, large asset managers had separate ESG and stewardship teams that worked more closely with specialist investment teams. In contrast, stewardship responsibilities were embraced directly by small asset managers' investment teams.

Both asset owners and asset managers reported increases in stewardship resourcing, mostly dedicated to the growth of stewardship teams and use of external experts. Participants were largely positive about the future, expecting growth in staffing and research budgets. Respondents also recognised the opportunity for more formal career progression and training in stewardship.

Engagement, collaboration and escalation
Development of the Code has been useful for engagement practices, with all respondents undertaking some form of engagement and escalation with companies. Most respondents identified collaborative engagement (working with other investors) as an increasingly important escalation tool. There was also evidence that the pace of introduction of stewardship practices in other asset classes and engagement with policymakers has increased.

Monitoring and reporting
Respondents see the Code as a useful framework which gives stewardship teams more influence on investment decisions within organisations and has led to improved stewardship reporting. The most notable benefit has been the emphasis on reporting activities and outcomes of stewardship, which interviewees believe has prompted a major change in behaviour. It has encouraged investors to be more reflective about their stewardship practices and give more consideration to improvements to their approach.

Some respondents found it difficult to judge stewardship effectiveness, what good engagement outcomes look like and to attribute engagement success to their organisation. Others highlighted that the time taken to produce stewardship reports is a challenge. Nevertheless, the increased emphasis on disclosure, engagement transparency and the move towards case study reporting, are all identified as positive changes influenced by the Code.

Tailoring ethics programmes

Although companies are often trying to achieve the same broad outcomes through their ethics programmes, and are often facing similar challenges, the solutions they develop need to be tailored to their particular business. The Institute of Business Ethics recently met with senior ethics practitioners to discuss ethics programme best practices.

Businesses with multinational operations are well attuned to some of the local differences in the countries in which they operate. Speaking up that seems the norm in some countries may be seen as disloyal in others. Differences in cultural attitudes and societal norms can mean that an approach to something like supply chain due diligence in one country may cause offence in another.To be truly inclusive and to shape consistently high standards of behaviour across an organisation, an ethics programme needs to build on common areas but also be tailored to take into account and reflect any significant differences. Ethics ambassadors or champions have a vital role to play across the business to help ensure that the messages are properly understood in what may be a very local context.

Best practices discussed included: developing benchmarks for speak up data where cultural and societal factors do not allow a meaningful comparison between cohorts; making sure that the range of case studies used to prompt discussion in training is wide enough to reflect the variety of roles and working environments in the business; the value of pre-deployment cultural awareness packs for managers making international moves; and leveraging the insights of internal audit and other allied functions operating across the business to a consistent standard.

Also seen as good practice was customising training materials to reflect local cultural norms (whilst maintaining consistency of outcomes) and understanding when messaging might be more impactful from very local rather than more senior managers.

Even for businesses only operating in their home markets, there are other aspects that should be taken into account when planning an ethics programme. These include: gender and racial diversity in the workplace; differences between desk-based roles and field workers; the different experiences of shift workers; the range of terms of employment in the workforce (a mix of permanent, temporary and part-time workers); and the growth of hybrid or home-working.

Feature

Doing less and achieving more

Ian White argues that it's time for boards to take it easy and to say 'No' to things they want to do.

If I said to you 'It's time for boards to take it easy' you would probably be shocked at my approach or at least question my judgement! But actually there is every reason to believe that boards should do this as they strive to be more effective. Perhaps it would help if I explained.

Nearly all boards I work with as a Board Effectiveness Reviewer have too much on their plate. This is particularly so for financial services companies but it extends to other sectors too. Savvy Chairs and Company Secretaries set the agenda so that the principal matters are dealt with first leaving more minor matters to the end of the meeting. So the CEO Report and Strategy are dealt with at the beginning of the meeting while minutes and action points come at the end. In this way the board is dealing with the most important agenda items first while people are at their most alert. It is an effective process of prioritisation. Why then do board meetings still last so long? Six, seven even eight hours? There might be prioritisation but there is an equal degree of exhaustion!

The answer is straightforward. Boards might prioritise but they still have an overriding objective of trying to do as much as possible. Their approach – well at least those who aim to work effectively – is to deal with the projects and items they *really* want to do first while leaving the secondary, less important matters – which boards *still* want to action – until later on in the meeting. So, yes good prioritisation but no reduction in workload. In this they follow the same approach most of us do to time management: make a long list (agenda) of things to deal with and try and tackle it as best we can. For those of us who are not good 'time' managers this means dealing with lots of small matters first because we don't like dealing with difficult, challenging matters and so often we don't get around to them or at least give them the attention they deserve (guilty as charged!); for the rest who manage their time rather better it means the important matters are considered and dealt with comprehensively while the rest are rushed towards the end of the day. Boards are no different here: it is very common to see numerous lengthy but important policies being considered and debated in the last five minutes of a board meeting giving an average of 35.5 seconds for each one to be discussed and approved!

So what should boards do to address this? In his recent book *Four Thousand Weeks: Time and How to Use it* (well worth reading by the way) Oliver Burkeman cites two very good examples which boards could adopt.

The first, is a reference from Elizabeth Gilbert about getting better at learning to say 'No!' – 'as the writer Elizabeth Gilbert points out, it's all too easy to assume that this merely entails finding the courage to decline various tedious things you never wanted to do in the first place. In fact, she explains, "it's much harder than that. *You need to learn how to start saying no to the things you do want to do, with the recognition that you have only one life*" (my emphasis)'. Boards, well most, will only have one life. There is a finite amount of time. So while there is merit in prioritising, a more effective way still is to deal with those matters and projects you absolutely want and need to do.

This means junking not only lots of perhaps interesting but unnecessary papers and matters (do we really need to include matters 'for information only'?) but also taking a long hard look at all the things you would like to deal with as a board and deciding which, reluctantly, you are going to discard leaving only the core matters. Dispensing with the unnecessary and the uninteresting should be easy (it isn't, of course, for both individuals and boards) but discarding something that you, as a board or exco would really like to pursue is harder still. But as Burkeman illustrates interesting but less critical projects will simply prevent you doing what you really should be doing: 'resist the allure of middling priorities' as these are not really important but still attractive enough to distract you away from what you really should focus on. It is a good lesson for us all whether individuals or boards.

> 'It is much easier for executives to produce papers outlining what they have done … rather than outline their forecasts and strategy for the future.'

This principle was brought home to me in a Board Effectiveness Review I undertook. The board had spent 18 months dealing with a major transaction. Extra board meetings had been arranged during this period; the exco had it as their main priority and the board had become very involved in the project as they needed to be. It dominated every meeting but was about to conclude when I undertook the Review. I recall asking one executive what, if anything, the board should stop doing. His answer was insightful: 'Once the project is completed, board members shouldn't look for other things to do and fill the time that the project once did. The Non-Executive Directors could actually do less work and reduce the time they spend in board meetings. That would be the smart thing to do.' It was a smart answer. I adopted this as a recommendation to the board: focus on the core, priority matters but don't feel the need to fill the extra time you now have. You can spend less time with the board and the company (although perhaps doing more site visits and enhancing visibility might be time well spent!).

Feature

‘But packing meetings and agendas is probably not the best thing to strive for if you want to be truly effective as a board.’

There are, of course, other ways in which the board can focus on the really core matters that it should be dealing with. First, it can be more forward looking in its approach. Many of the boards I observe spend much of their time reviewing past information – typically financial data. They do so because directors hold ultimate responsibility for what the company has done (or not done!). But while this is important for context there is little if anything that boards can do to change what has gone on before. However, many CEO and CFO Reports provide reams of past performance information which the board then takes time to discuss. Why? Because that is easy. It is much easier for executives to produce papers outlining what they have done (even if it makes for uncomfortable reading although some executives are perhaps good at glossing over this!) rather than outline their forecasts and strategy for the future. Easier still for the non-execs to discuss and critique this rather than delving into the uncertain and unknown. Culture may eat strategy for breakfast as Peter Drucker once said but strategy is difficult nonetheless.

However, it is one of the most important, if not the most important roles for the board. Again to be really forward looking a different approach is needed from directors. At a board strategy day I recently observed the focus was much more on asking powerful questions rather than coming up with all the answers on how the company would progress in the future. That is what made it such an effective session. Clarifying what the company could do and framing the right questions that might take it there is much more beneficial than coming up with some (frequently) ill thought out and peripheral answers and solutions that will probably end up never being achieved in any event.

Secondly, boards really must insist on presenters not reading out their presentations. It is very common to hear a presenter say ‘I will take the paper as read’ (or for the Chair to remind them that this should be the case!) then for them to go through all of the points again. The real value in an agenda item is not the paper but the board discussion. Repeating what is said in the paper adds zero value and just curtails valuable board time. So this too is an area boards must be disciplined in saying ‘No’ to even if they like presenters reading out what they have written (do any of them?!)

Boards always seem to have too much on their agenda. There are always extra things that they could do. But packing meetings and agendas is probably not the best thing to strive for if you want to be truly effective as a board. Making that difficult decision of what cannot be pursued – not because you don’t want to or because it isn’t relevant but quite the opposite – but it will distract you, nonetheless, from doing what will make the board even more effective and the company more successful. So it is very much time for boards to be tougher in saying ‘No’ more often. That might make directors’ lives easier in terms of workload even if it does not in respect of decision-making or leading the company forward.

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Feature

Shareholder engagement – a year-round activity

Domenic Brancati, Don Cassidy and **Hannah Orowitz** discuss why engagement matters, stakeholders, team members, evaluation and post-engagement activities, which are equally important.

Shareholder engagement has expanded beyond the proxy season to become a year-round, cross-functional strategic effort as public companies increasingly seek to engage with investors on a growing variety of topics, including ESG issues.

In recent years, ESG considerations have increasingly influenced investors' proxy voting decisions, and investors of all types have become more active in their shareholder stewardship. Large institutional investors have become increasingly sophisticated in integrating specific engagement histories into their ongoing analysis of corporations. For example, Legal and General uses its LGIM ESG score to encourage change at portfolio companies as it deems warranted. Similarly, State Street's proprietary ESG scoring system, R-Factor, evaluates companies' ESG disclosure efforts relative to peers and market expectations.

We are also seeing increased overlapping of some ESG issues, where practices in one area may impact another and lines between E, S or G begin to blur. For example, shareholder opposition to executive pay packages remains a highly visible governance issue across Europe, and in some cases, that opposition is also tied to the company's ESG performance. Allianz Global Investors' voting policy demonstrates this interconnectedness; The investor will oppose remuneration votes at large UK and European companies if the pay structures do not link executive pay to the achievement of relevant ESG metrics. Globally, board oversight of ESG is increasingly important to investors, as is evident in the emphasis from the largest investors, such as BlackRock, Vanguard and State Street, on understanding how boards oversee key issues and engage directly with non-execs responsible for oversight of these matters.

Given this evolving landscape, engagement and effective board education are necessary to help prevent the rising challenges posed by investors' continued scrutiny of companies' ESG practices. Notably, while headline numbers showed slightly muted support for environmental and social shareholder proposals in the US this season as compared to last, that shift was due to a combination of perceived progress on the part of companies coupled with highly ambitious asks from shareholder proponents. At the same time, we saw an almost five-fold increase in the number of instances where climate-related considerations factored into investors' decisions to vote against the re-election of directors, demonstrating the continued need to understand investors' evolving expectations. Transparent and active dialogue between investors and companies is necessary to understand these expectations on the one hand and communicate how such issues are being overseen and progressed.

Value of engagement

Shareholder engagement can take many forms. Investor interactions represent a valuable opportunity to influence and educate shareholders. At the same time, effective engagement gives companies a deeper understanding of their investor's ESG expectations and proxy voting policies. Ongoing discussions throughout the year offer an opportunity to develop relationships, anticipate and prepare for potential issues at the annual meeting and mitigate or avoid activism while building credibility and goodwill with investors.

Shareholder engagement programmes should be tailored for each company and evolve as the company faces new issues and challenges and as the focus of investors shifts. For example, engagement is particularly critical for companies that experienced disappointing voting outcomes at their annual meetings as it demonstrates responsiveness to concerns raised by investors. Investors and proxy advisors will scrutinise companies' responsiveness to investor feedback and evaluate whether the actions taken are sufficient to warrant their support for management at future meetings.

But before engaging shareholders, they need to do their homework to understand investor priorities and what questions they might ask. Preparing for these conversations is critical to facilitating a successful engagement, and having a clear agenda in mind at the time a meeting is requested will be well-received. Companies should also be aware that investors follow post-engagement actions to assess progress.

Engagement is a critical defence against activists

Investor activism can take many forms. Traditional hedge fund activists may take a position in a company's stock and agitate for various operational, strategic, governance or management changes. Or perhaps a dissident may seek to gain one or more seats on a company's board of directors.

Non-traditional activist campaigns – including those launched by pension funds, mutual funds, investor coalitions and individual investors – may include actions such as public letter-writing campaigns and publicised votes against management proposals or one or more of a company's director candidates during the annual meeting process. Boutique investment firms like Engine No 1 ran highly successful public activist campaigns against directors in the last couple of years, agitating change at companies while simultaneously attracting investors. Even the largest passive investors have added their support to these small investment firms' highly effective ESG-oriented activism campaigns, enabling them to 'punch above their weight class'. Most potential proxy fights settle before reaching a vote because of pressure from activists or shareholders. Whether a company decides to settle with an

Feature

activist or the campaign results in a contested meeting, the situation will likely be costly and distracting for the company. Companies that develop strong relationships with their institutional investors are in a better position to respond to the actions of investor activists should the need arise. The board will already have an existing track record of proactive outreach and understanding of their investors' priorities, including how it may align with the demands of the activist.

Preparing for shareholder engagement

It would be ill-advised for a company simply to go through the motions of shareholder engagement to 'check a box'. Effective engagement starts with transparency, authenticity and accountability with investors.

Boards and senior management must be thoroughly prepared to engage investors on their topic(s) of interest and address any challenges the company may face. Companies must have a clear understanding of their goals for the engagement – in addition to the investor's goals – and articulate those goals at the time they request a meeting.

Companies with a well-defined meeting agenda are most likely to receive a positive response and hear directly from shareholders on what matters are most influential to their decision-making. Having a clear set of goals increase the chances of creating the best outcome.

Developing an effective strategy to reach key investors will be case-specific for each company, but a few common steps to prepare include:

- Obtaining an up-to-date analysis of the company's largest active and passive institutional investors.
- Conducting a thorough review of your unique situation and challenges.
- Determining who should participate. While your CEO and investor relations department often speak regularly with your investors' portfolio managers, investors' stewardship teams often make or influence key voting decisions and should be included in the shareholder engagement discussions. Investors increasingly have dedicated teams focused on ESG topics, especially if product circularity or emissions reduction targets are on the agenda. It is important to understand when to include subject matter experts, board members or management team members in the meeting.
- Developing clear engagement materials that will resonate with your investors and address their areas of focus.
- Incorporating investors' feedback as appropriate post-meeting and clearly disclosing how you did so.

Year-round engagement cycle

Shareholder engagement is best thought of as a series of connected events undertaken before, during *and* after the annual meeting. In general, year-round shareholder engagement can be broken down into three distinct periods – before the annual meeting season (pre-proxy), once you have filed a proxy statement (proxy season) and post-meeting (post-meeting review):

1. *The pre-proxy season*, commonly called the 'off-season', often commences around September, although we have seen this shift earlier in recent years. This period provides an opportunity for companies to engage on a range of topics, such as fundamental strategy, compensation and ESG matters, including any impending material developments, at a time when both companies and investors may have more time to dedicate to understanding and addressing any issues. Companies may take this time to gauge investors' views on recent developments or potential changes under consideration, or to negotiate with potential proponents on specific issues before formalising their positions. Information gathered from these meetings should be reviewed carefully, shared with your board, and considered for future decision-making.
2. *Proxy season:* Once the proxy statement has been finalised and active solicitation has begun, engagement can help an issuer secure a favourable voting outcome. Some solicitations will be routine, but an issuer may need targeted, strategic shareholder engagement if faced with vote opposition or a negative recommendation from a proxy advisory firm.
3. *Post-meeting review:* After the annual meeting concludes, it is important to review and understand voting results thoughtfully. Did certain directors receive lower support than others? How did support for compensation decisions this year compare to last? Post-meeting review is particularly important following a highly supported contested shareholder proposal or low level of support for an issue, such as a director election. Undertaking a fulsome review prepares you to identify potential red or yellow flags that should be carried forward into your next off-season engagement to collect input from your investors. Understanding investors' rationale behind those voting decisions will be essential to ensure that you make informed decisions about the next steps.

Shareholder engagement will likely position your company as transparent and proactive, helping to foster a positive issuer-investor relationship. Reaching out to investors for feedback opens lines of communication to discuss the reasons behind the voting decisions and allows companies to better prepare for similar situations in the future. Responsive and active engagement is a year-round exercise that happens before, during and after the AGM vote and is only one step towards gaining investor trust and support. We think of engagement as an ongoing, open line of communication between companies and shareholders that educates and nurtures understanding on both sides.

Domenic Brancati is Global COO of Georgeson Global, Don Cassidy is Global Head of Corporate Governance and Hannah Orowitz is US Head of ESG.

Feature

A code of conduct for directors

Roger Barker introduces the IoD's vision for board members from all UK entities to sign-up to a widely recognised code of conduct on a voluntary basis.

Recent corporate scandals and collapses in the UK – including those at Carillion, BHS, Patisserie Valerie and P&O Ferries – suggest that UK business leaders do not always fulfil the expectations of wider society, either in terms of their individual behaviour or decision-making.

A common way to address conduct issues in many professional settings is to define a code of conduct for relevant persons and hold them accountable. However, most UK company directors are not subject to a formal code of conduct. This contrasts with the situation in the US, where codes of ethics form part of the overall framework of business regulation. One of the consequences of the Sarbanes-Oxley Act 2002 was to require many US corporations to adopt and disclose a code of business conduct and ethics for directors, officers and employees. Each company within the scope of these requirements may determine the content of its own code. However, certain topics must be addressed, including policies relating to conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of company assets, compliance with laws, rules and regulations, and encouraging the reporting of any illegal or unethical behaviour.

Codes of conduct are, however, a feature of many other aspects of UK business life, including the professional frameworks relating to accountants, medical practitioners, and lawyers. In these fields, a code of conduct is seen as an essential component of the licence to operate and a meaningful source of professional accountability.

The absence of a code of conduct for UK board members is perhaps surprising, given the crucial role that directors play as leaders, role models and decision-makers in society. Appropriate director behaviour is as pivotal to the legitimacy and performance of business as that of any other professional role (perhaps more so). This has led the IoD and its members to conclude that a code of conduct for directors is an important missing element in the current UK business framework.

What would a meaningful code of conduct for directors look like? Ideally, it should articulate a series of widely-accepted principles which reflect the behavioural expectations of wider society vis-à-vis the business community. These expectations increasingly demand a proactive attitude to issues such as climate change, diversity and inclusion, business purpose and the treatment of employees and suppliers – as well as more traditional requirements relating to professional competence, lawfulness, independence, loyalty to the company and confidentiality.

'One of the consequences of the Sarbanes-Oxley Act 2002 was to require many US corporations to adopt and disclose a code of business conduct and ethics for directors, officers and employees.'

Codes of conduct for directors already exist in certain jurisdictions, eg Hong Kong, Singapore and South Africa, where they have been published by national directors' associations. In the UK, the IoD pioneered the first Code of Professional Conduct for Directors in 1998. For a number of years, it was applicable to IoD members as a condition of membership. According to the preamble to the edition of the Code published in 2003, 'this Code has been written in order to help directors simultaneously meet high standards of professionalism and ethics'. However, during the 2000s, the IoD's Code of Professional Conduct for directors was absorbed into the Chartered Director framework, and currently only applies to holders of the Chartered Director Qualification – the IoD's 'gold standard' professional qualification for directors.

Going forward, the IoD's vision is for board members from all UK entities to sign-up to a widely recognised code of conduct on a voluntary basis. By committing themselves to the code, directors would signal their willingness to apply high ethical and behavioural standards in their governance and leadership activities. They would also agree to submit themselves to any accountability processes associated with the code.

Although the code would ideally be supported by government, it would be operated by the business community rather than by a regulator or government department. By remaining at arm's-length from the operation of the code, the UK Government would be able to demonstrate its commitment to high governance standards whilst avoiding accusations that it is adding to the overall burden of State-imposed regulation. At the same time, such an approach would enable the business community to demonstrate its own determination to address societal concerns relating to poor standards of business behaviour.

The idea of a code of conduct for the director community is strongly supported by the IoD's members. In a members'

Feature

‘By committing themselves to the code, directors would signal their willingness to apply high ethical and behavioural standards in their governance and leadership activities.’

survey conducted in May 2022, 78% of respondents agreed that directors should be subject to a code of conduct – either on a mandatory or voluntary basis. In our view, a voluntary rather than a mandatory code would be the right way forward at this stage – given the need to win the hearts and minds of business leaders and avoid the impression that the code is yet another compliance burden that is being imposed on business.

Our initial thinking is that all signatories to the code could appear on a publicly viewable register. In addition, signatories could be encouraged to disclose their commitment to the code in the annual report of their entities, such as through an appropriate kitemark. A ‘speak up’ process could also be established to allow the reporting of poor conduct, and an appropriate investigations and sanctions process would also need to be defined.

The latter would require careful thought – as an accountability process operated by the business community would not have the status of a legal process. For example, it would not have the power to legally prohibit someone from serving as a company director (which is a power reserved to a court of law). Nonetheless, for the code to incentivise good behaviour in a meaningful way, there would need to be material consequences for those signatories to the code who egregiously fail to live up to its basic principles. These could include removal from the register of signatories or public censure.

It is important to note that a code of conduct for directors is something distinct from a corporate governance code (such as the UK Corporate Governance Code) or the general legal duties of directors which are defined in the Companies Act 2006. A governance code describes best practices relating to the structure, composition, activities and functioning of the board of directors as a whole. In addition, governance codes typically only apply to large, listed companies. They are not primarily focused on articulating high-level principles of individual conduct which individual board members should embody in their behaviour. Directors’ general legal duties are baseline fiduciary responsibilities that directors owe to their respective organisations, and do not speak to many desirable aspects of director behaviour. For that reason, a code of conduct would be complementary to the existing governance code framework and directors’ fiduciary requirements.

The IoD has written to the senior UK Government Minister with responsibility for business, Kwasi Kwarteng, and sought government feedback on the initiative. The response of the Secretary of State has been positive: ‘I welcome the proposals you have put forward for a voluntary code of conduct for directors. I am delighted that the Institute is keen to take practical steps on a voluntary basis to drive standards up further and I hope it will be successful in reinforcing confidence in the UK as a place where business is done well .… I would encourage you in your business-led approach’.

Such a supportive response from government provides a helpful basis on which to move forward towards the articulation of a code. The IoD plans to establish a high-level working group consisting of leading directors, governance experts and representatives from relevant stakeholder groups, such as institutional investors, regulators and academics. The task of this group will be to draft the wording of a code and define the associated accountability mechanisms. We would also envisage seeking input from a wide range of interested parties through a public consultation process.

‘A code of conduct for directors is not a silver bullet that will transform business behaviour overnight.’

The aim is to define a code that enjoys broad support from the business community as a whole. Although no code could ever achieve universal agreement, a high level of consensus around its contents will be a key source of its influence and credibility. Although the code is not intended to be mandatory, we hope that peer pressure and a desire to signal a commitment to high behavioural standards will encourage many directors to sign up to the code and be held accountable to its principles.

A code of conduct for directors is not a silver bullet that will transform business behaviour overnight. It is rather a starting point in a journey towards better director conduct and improved governance. It will serve to make explicit the expectations that society has for those persons entrusted with making some of its most important economic decisions. And it will provide a reputational incentive for them to respect those expectations. We welcome the feedback and support of all of those interested in assisting us in implementing this initiative.

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Index

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