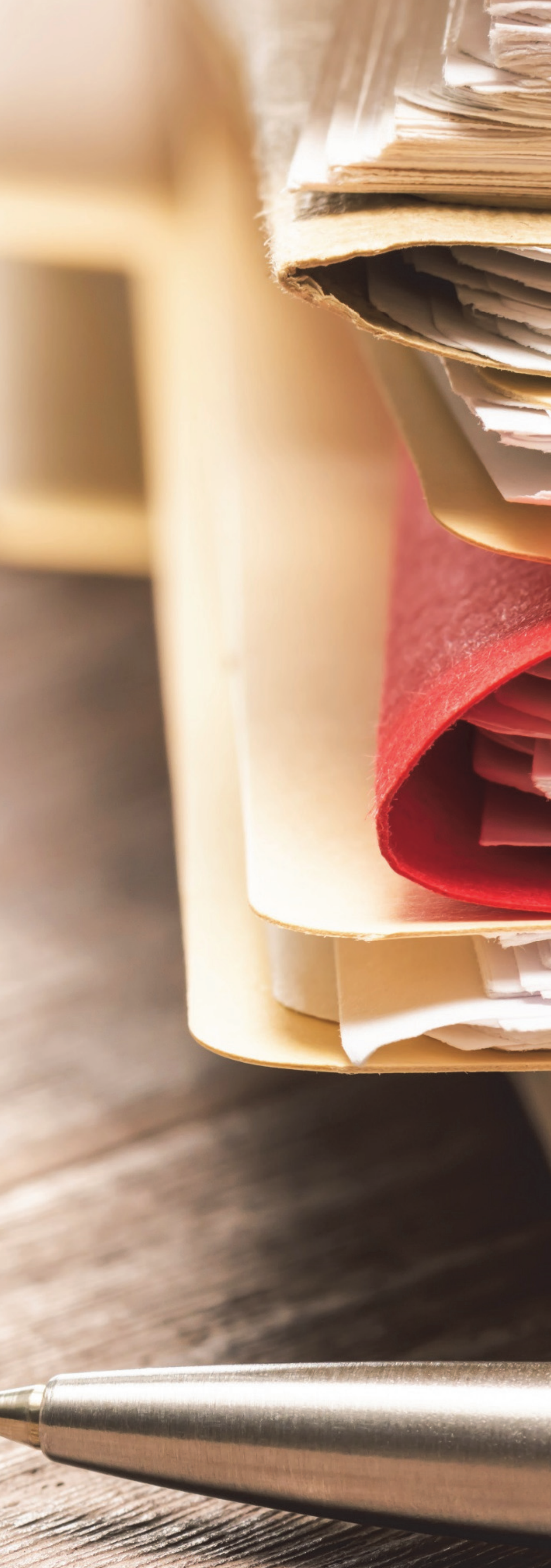
KPMG MAKINSON COWELL

Review of the 2017 AGM season



September 2017

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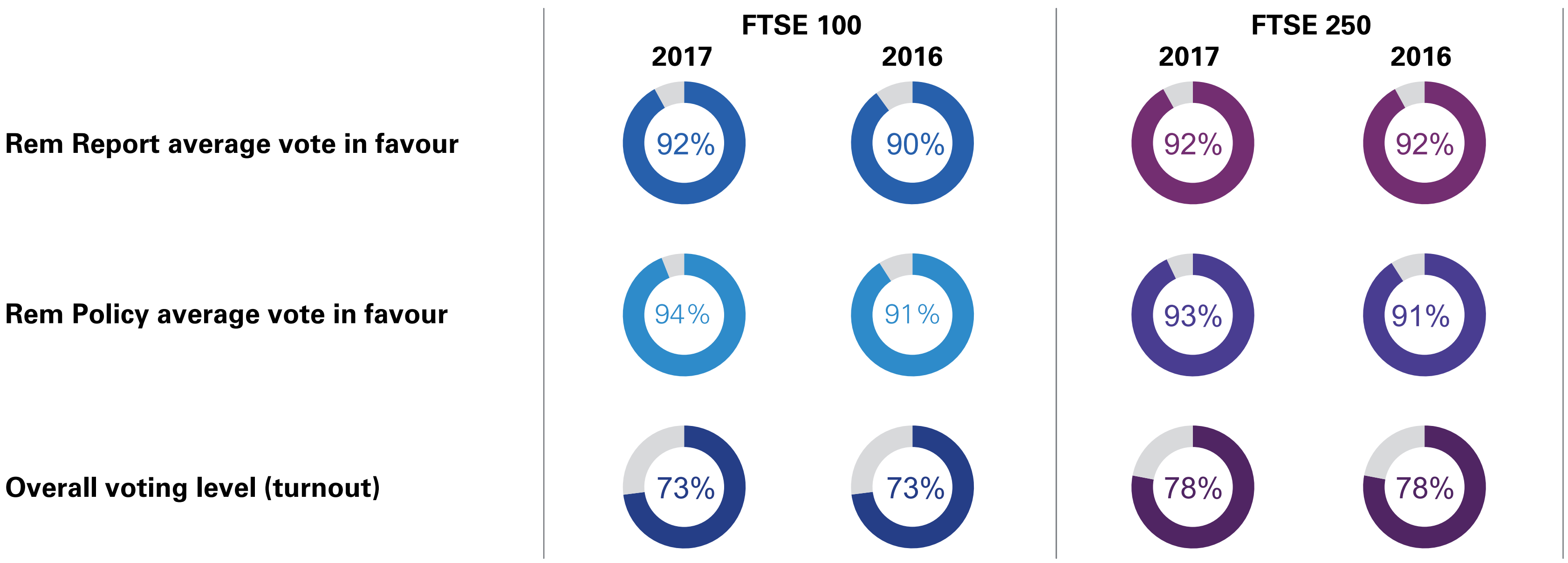
Introduction

This review considers the AGM voting results for FTSE 100 and FTSE 250 companies (excluding Investment Trusts), up to the end of August 2017.

The average vote in favour for the Directors' Remuneration Report in the 2017 AGM season was 92% for both FTSE 100 and FTSE 250 companies. This is broadly unchanged from 2016 where the level of support was 90% and 92% respectively for FTSE 100 and FTSE 250 companies.

There has been a similar level of support for the Remuneration Policy whenever it has been voted on, with on average 94% support within the FTSE 100 and 93% support in the FTSE 250 in 2017 compared to 91% in 2016.

The overall voting level or turnout has also been very consistent between 2017 and 2016. The FTSE 100 average voting level remains at 73% with the more UK focused and concentrated ownership of FTSE 250 companies leading to an average vote of 78% so far this year, which is again consistent with the average voting level in 2016.



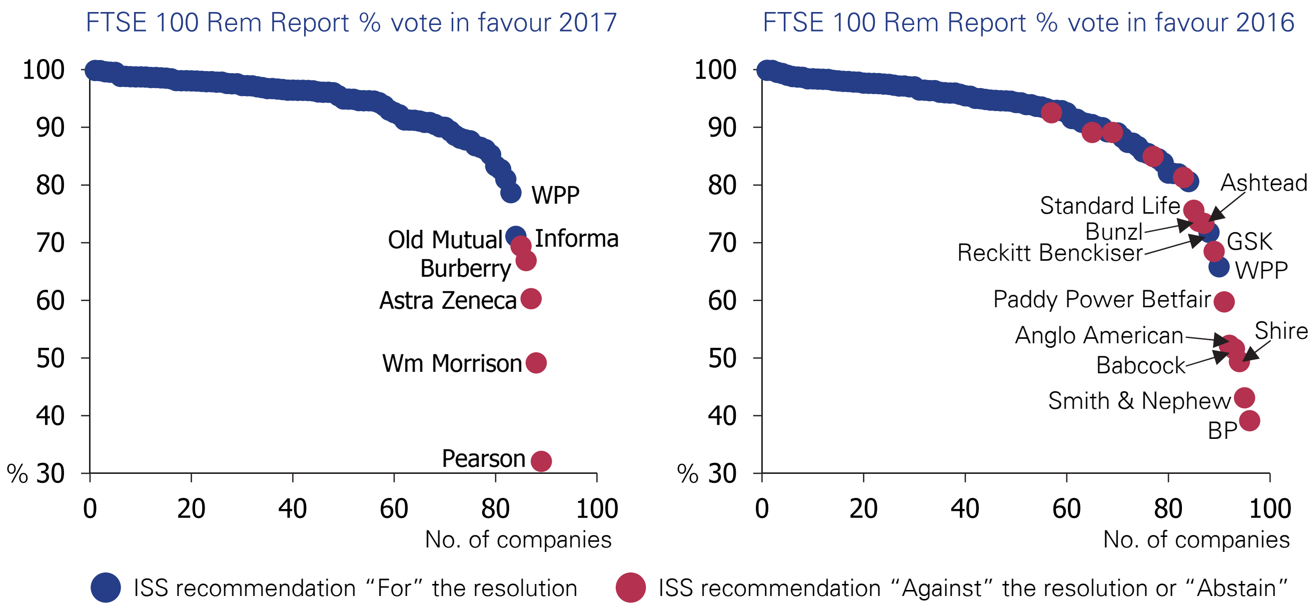
The analysis considers votes in favour of any resolution as a proportion of total votes cast. Hence votes withheld are treated as abstentions and therefore arise from shareholders that are dissenting on a particular issue.

The UK Corporate Governance Code states that "When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote". Generally accepted practice is that less than 80% support for a particular resolution would typically constitute a significant level of shareholder dissent and this is the threshold applied in this review.

FTSE 100 Rem Report

The charts to the right plot the level of support at FTSE 100 companies on the Directors' Remuneration Report resolution for the 2017 year to date and 2016. The 2017 data covers the 90 companies to have held their AGMs up until 31 August 2017. Each dot represents the voting at a particular FTSE 100 company.

The chart distinguishes companies that received a positive voting recommendation from Institutional Shareholder Service (ISS) – blue dot, and those where ISS recommended that shareholders vote against or abstain on the DRR resolution – pink dot.



Source: KPMG Makinson Cowell analysis, ISS

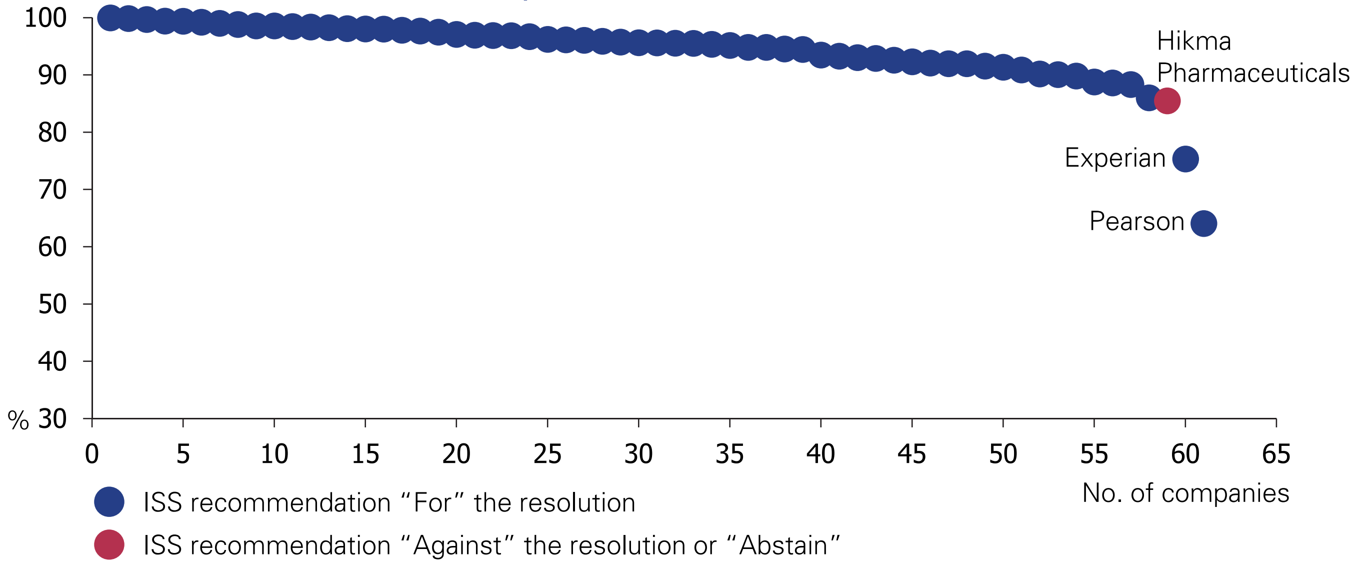
- Pearson has been the only FTSE 100 company where the Directors' Remuneration Report resolution was defeated in 2017. More than two-thirds of shareholders either voted against or abstained on the Pearson DRR, with most shareholder concerns centred around the bonus payments in a year where the company had issued a profit warning.
- Wm Morrison, AstraZeneca, Burberry, Informa, Old Mutual and WPP were the other FTSE 100 companies to receive less than 80% support for the DRR. The DRR at Morrisons was only narrowly approved following an increase in the LTIP award from 240% to 300% of salary for the CEO/CFO. The principal issue at AstraZeneca related to its LTIP, where the remuneration committee was proposing changes to the performance conditions. At Burberry shareholder concern centred around the remuneration package for the incoming CFO, whilst at Informa some shareholders were concerned at whether the LTIP EPS target was sufficiently challenging.
- The charts above clearly show a smaller number of companies encountering significant shareholder dissent in 2017 compared to 2016. The Pearson, Wm Morrison, AstraZeneca, Burberry and Informa AGMs were the only meetings this year where the ISS vote recommendation was for shareholders to vote against the DRR, whereas there were 14 negative ISS vote recommendations in 2016. From our privileged position as an advisor to many FTSE 100 companies we believe that the extensive shareholder consultation undertaken by many companies this year has led to outcomes on remuneration issues which are more in tune with shareholder views.

FTSE 100 Rem Policy

The requirement for a binding vote on a company's Remuneration Policy first came into effect in 2014 and any approved policy can stay in place for three years before being voted on again by shareholders.

The three year anniversary of the initial binding Remuneration Policy vote has led to around two-thirds of FTSE 100 companies putting their Remuneration Policy to a vote in 2017.

FTSE 100 Rem Policy % vote in favour 2017



Source: KPMG Makinson Cowell analysis, ISS

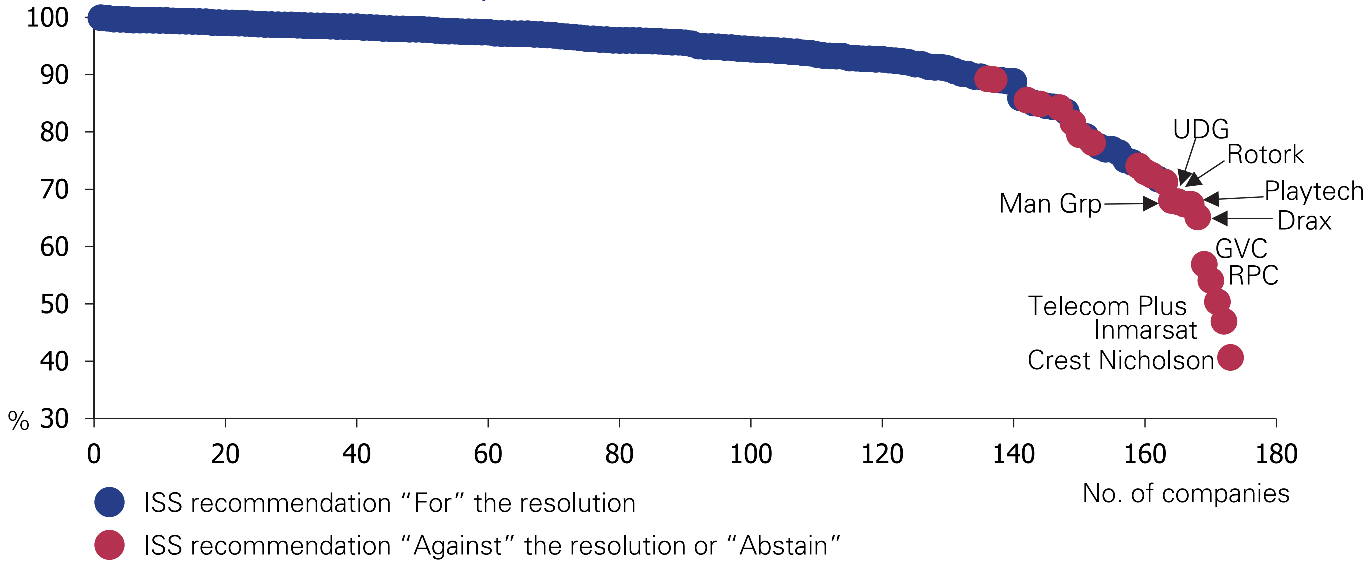
- All FTSE 100 Remuneration Policy resolutions have been approved by shareholders so far in 2017, with just two companies receiving less than 80% support from shareholders.
- Pearson saw the lowest vote with just 64% support for its proposed new policy. There was also a significant dissenting vote against the re-election of the RemCo chair at Pearson.
- The lower vote on the Remuneration Policy at Experian appears to reflect the fact that the company has retained the Co-investment plan in the policy and not introduced a two year post-vesting holding period for any long term awards.
- ISS recommended that shareholders vote in favour on all the FTSE 100 proposed Remuneration Policy votes so far in 2017, with the exception of Hikma Pharmaceuticals where ISS refers to "persistent concerns around the quantum of reward" in respect of the Executive Incentive Plan.
- Early on in the 2017 AGM season Imperial Brands withdrew its proposed new Remuneration Policy after shareholder opposition to the increase in the maximum LTIP award for the CEO. Imperial Brands had most recently put its Remuneration Policy to a vote in 2015 and hence it did not need to seek shareholder approval in 2017.

FTSE 250 Rem Report

The chart to the right plots the level of support at FTSE 250 companies, excluding investment trusts, on the Directors' Remuneration Report resolution for the 2017 year to date and covers 171 companies up until 31 August 2017. Each dot represents the voting at a particular FTSE 250 company.

The chart distinguishes companies that received a positive voting recommendation from Institutional Shareholder Service (ISS) – blue dot, and those where ISS recommended that shareholders vote against or abstain on the DRR resolution – pink dot.

FTSE 250 Rem Report % vote in favour 2017



Source: KPMG Makinson Cowell analysis, ISS

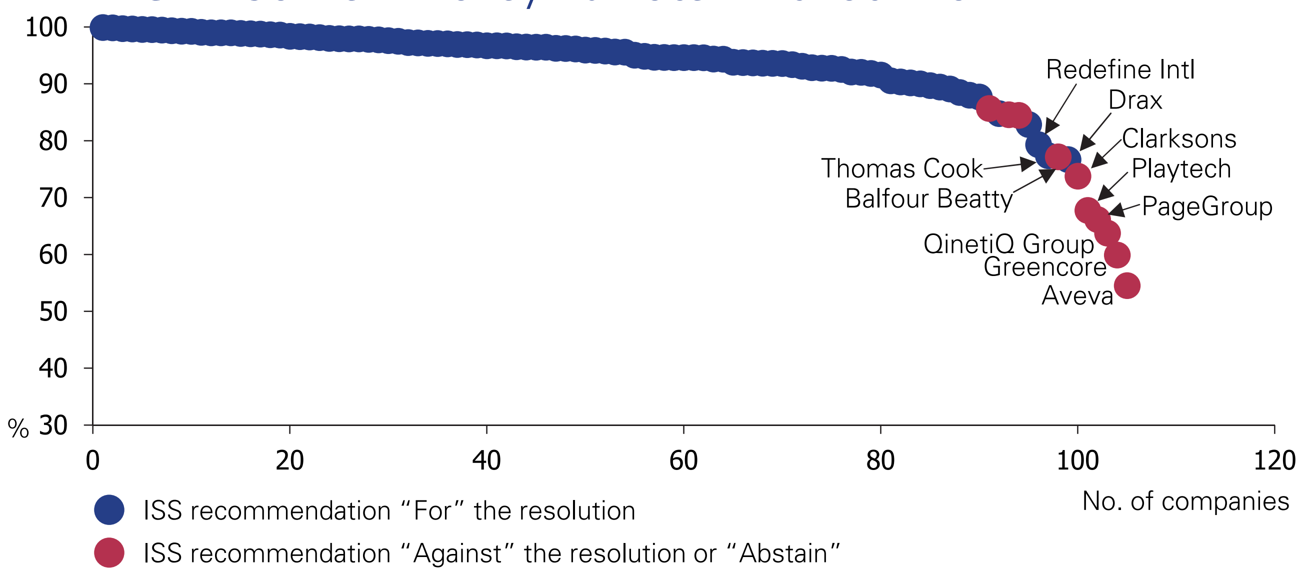
- The DRR resolution was defeated at the Crest Nicholson AGM, with 56% of shareholders voting against. Shareholders were concerned that the PBT target for the 2017 LTIP award was significantly below the targets for the 2016 and 2015 LTIP awards and may therefore not be sufficiently stretching.
- The DRR at Inmarsat was approved by shareholders, but taking abstentions into account, 53% of shareholders were not supportive. The Bonus Share Award (BSA) at Inmarsat for 2016 was awarded in full, despite the targets not being fully met.
- There was also a very close call at Telecom Plus, where the DRR was approved with just 50.4% support. Despite this low vote, which arose from a number of remuneration issues, Telecom Plus does not appear to have complied with section E2.2 of the UK Corporate governance code in that it did not explain when announcing the result of the AGM what actions it intends to take to understand the reasons behind the vote result.
- In total 24 FTSE 250 companies received less than 80% support for the DRR resolution, with ISS recommending a negative vote in 16 instances.
- The 24 FTSE 250 companies to receive less than 80% support for the DRR in 2017 is an increase from 20 such instances in the whole of 2016. This greater level of dissent on the DRR for FTSE 250 companies this year is in contrast to the FTSE 100 situation, where we have seen less dissention in 2017 compared to 2016.

FTSE 250 Rem Policy

Of the 171 FTSE 250 companies (ex-investment trusts) to hold their AGM so far in 2017, 105 also put their Remuneration Policy to a vote.

Once again, the chart distinguishes companies that received a positive voting recommendation from Institutional Shareholder Service (ISS) – blue dot, and those where ISS recommended that shareholders vote against or abstain on the DRR resolution – pink dot.

FTSE 250 Rem Policy % vote in favour 2017



Source: KPMG Makinson Cowell analysis, ISS

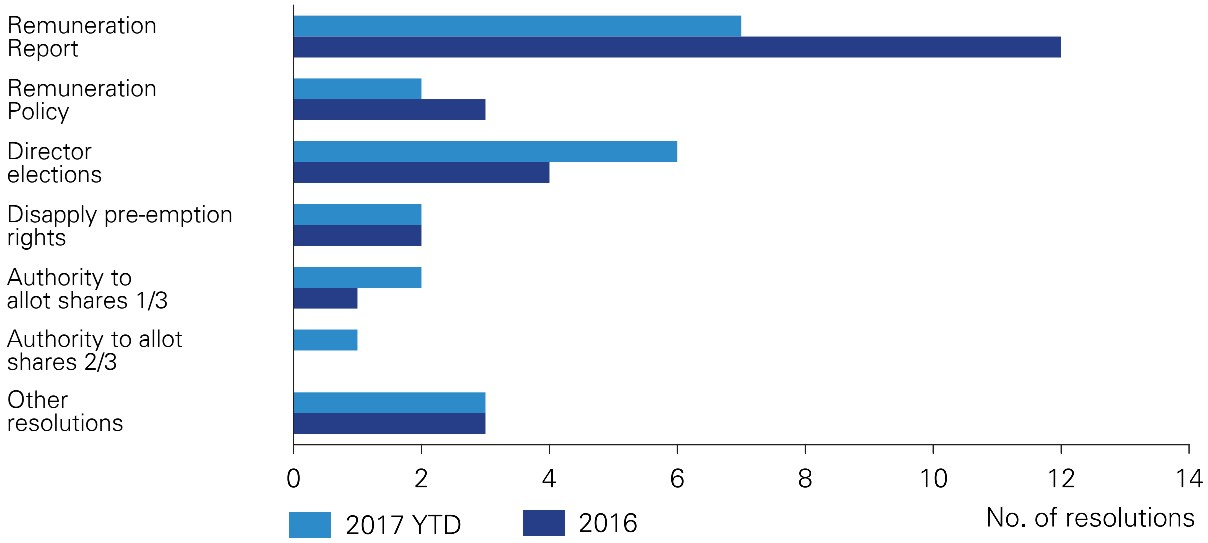
- All FTSE 250 Remuneration Policy resolutions have been approved by shareholders so far in the 2017 AGM season. The lowest level of support was at Aveva, the UK technology company, where just over 54% of shareholders voted in favour of the new policy, which included a new non-performance related restricted share scheme. Shareholder concerns related to the fact that the new restricted share scheme would run in parallel rather than replace the existing LTIP and the theoretical maximum pay-out on the new policy not showing a sufficient reduction to reflect the increased certainty arising from a restricted share award.
- The proposed Greencore Remuneration Policy included an increase in the maximum Performance Share Plan (PSP) award from 100% to 200% of salary, without any apparent stretch in the performance criteria. The issue at QinetiQ related to the proposed changes in the long term incentive scheme, which some shareholders considered put too great an emphasis on annual rather than longer term financial performance.
- At Playtech, where there was only 68% support for the Remuneration Policy resolution, the AGM was immediately followed by a General Meeting to vote on a revised Remuneration Policy. This revised policy was approved with 84% support. However, at the General Meeting shareholders rejected the proposal for a one-off share award to the CEO.
- A number of FTSE 250 companies withdrew proposals for a revised Remuneration Policy just ahead of the AGM as a result of shareholder consultations. Companies that withdrew the Remuneration Policy resolution included Aggreko, Chemring and Safestore.

FTSE 100 resolutions

The next two pages consider the 2017 AGM season in terms of the number of resolutions receiving less than 80% support and not just remuneration related matters.

As with all the data in this review, the analysis considers votes in favour of any resolution as a proportion of total votes cast. Hence votes withheld are treated as abstentions and therefore arise from shareholders that are dissenting on a particular issue.

FTSE 100 resolutions <80% support 2016-2017



Source: KPMG Makinson Cowell analysis

- As previously highlighted, seven FTSE 100 companies in 2017 received less than 80% on the DRR and just Pearson and Experian received less than 80% support for the Rem Policy vote.
- As regards resolutions to re-appoint directors we have seen six directors receiving less than 80% support in 2017, compared to only four such instances in 2016.
- It appears that shareholders are looking more closely at the number of appointments that a director holds and whether the director could be "overboarded". This was the issue for Ireena Vittal at Compass and Irene Lee at HSBC, who were re-elected with 60% and 71% support respectively.
- Two of the board members at Reckitt Benckiser received just 60% support on their re-appointment because of a serious issue relating to a product recall in South Korea. Finally, Elizabeth Corley at Pearson received just 73% support because of her role as the Remuneration Committee chair and Vassi Naidoo at Old Mutual received just 79% support as he is a non-independent director, but is a member of the Audit Committee.
- The technical resolutions relating to the authority to allot shares and disapplication of pre-emption rights continue to illicit some shareholder dissent. In particular Capital Group, M&G and Baillie Gifford routinely vote against the authority to allot an additional 5% of the share capital on a non pre-emptive basis in the event of an acquisition or specified capital investment.

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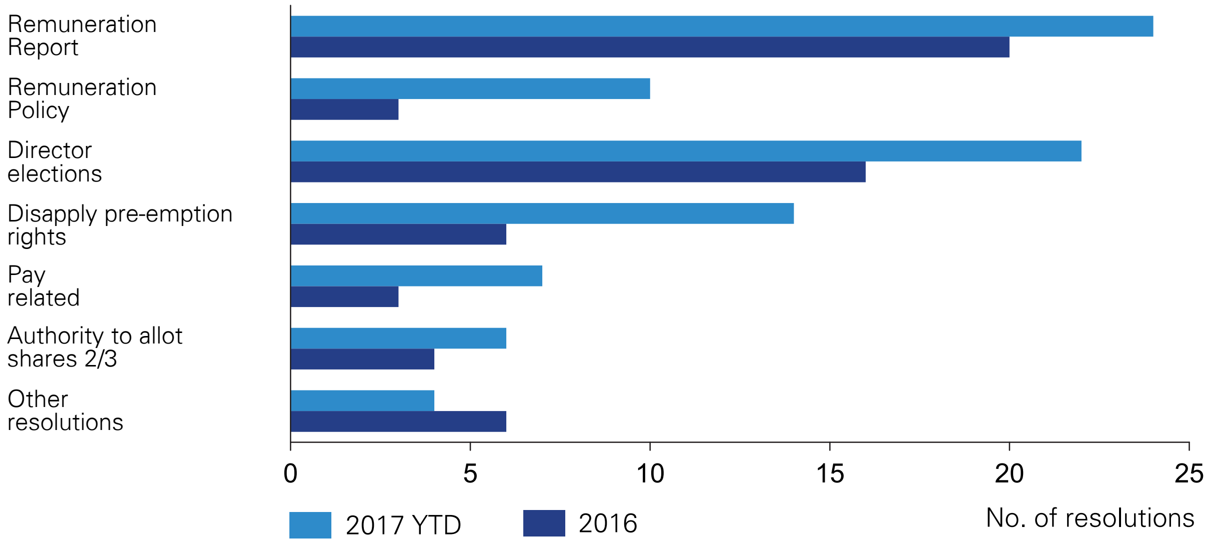
FTSE 250 resolutions

This final slide considers the number of AGM resolutions receiving less than 80% support at FTSE 250 companies in 2017.

FTSE 250 resolutions <80% support 2016-2017



Source: KPMG Makinson Cowell analysis

- In addition to Crest Nicholson, where the DRR resolution was defeated, a further 23 FTSE 250 companies received less than 80% support for the DRR and ten companies received less than 80% support for the approval of the Remuneration Policy.
- 22 director re-election resolutions at FTSE 250 AGMs received less than 80% support, with three instances arising at the Centamin AGM. At Centamin shareholders voted by two-to-one against the re-election of Trevor Schultz, who had temporarily taken on the chair of the Remuneration committee following the departure of another director. Following the AGM the directors re-appointed Trevor Schultz to the board, although he was not put back onto the Remuneration Committee.
- Eva Lindqvist at Bodycote was re-elected to the board, but taking abstentions into account she received just 47% support from shareholders due to her sitting as a NED on seven other boards.
- In overall terms there was a greater level of dissent on FTSE 250 director re-elections in 2017 compared to 2016, a pattern that we also saw within the FTSE 100 constituency as well. In the case of FTSE 250 companies the most common areas of shareholder concern arose where a director was considered to be non-independent due to a connection with a shareholder, yet the director still sat on one or both of the Remuneration or Audit committees.
- There have been two examples of FTSE 250 companies not achieving the required 75% support for the Special Resolution to approve the disapplication of pre-emption rights in respect of the issue of an additional 5% of the share capital on a non pre-emptive basis in the event of an acquisition or specified capital investment. The companies impacted were AA plc, which received just 64% support and Tullow Oil where only 72% of shareholders voted in favour of this resolution.

Conclusions

Despite the increasingly febrile atmosphere as regards executive remuneration from both the press and government since the end of 2016, in overall terms the average level of support for the Directors' Remuneration Report and Remuneration Policy resolutions in 2017 remained above 90% and as the chart on page four of this review clearly shows, a smaller number of FTSE 100 companies encountered significant shareholder dissent on the DRR in 2017 compared to 2016.

Just two remuneration reports were voted down across the FTSE 350 in 2017, at Pearson and Crest Nicholson and all remuneration policy resolutions were passed by shareholders.

Whilst this might suggest business as normal on remuneration matters, it is also apparent that companies have in general been listening to shareholders, in part because of the greater dialogue required this year with the binding vote on remuneration policy required by a majority of companies. This increased shareholder dialogue led in some cases to modifications to remuneration plans, which in turn helped companies to acheive a greater level of shareholder support.

Following on from the July 2016 report of the Executive Remuneration Working Group, which was established by the Investment Association, there was an expectation that the 2017 AGM season would see an increasing number of companies putting alternative options to the traditional LTIP model to shareholders, such as restricted share schemes. In practice very few companies proposed significant changes to their remuneration policies this AGM season and some of those that did go down this path decided to withdraw proposals for new remuneration policies just prior to their AGM after receiving negative shareholder feedback. Looking ahead companies that attempt to move towards restricted share schemes will need to demonstrate that the increased certainty of pay-out is coupled with a significant reduction in the maximum reward and that such schemes reduce complexity and are not in addition to existing arrangements. Shareholders may also be more wary where the proposed new scheme, which is almost certain to pay-out, is replacing an LTIP which has not paid out to executives in recent times.

Away from remuneration matters, shareholders seem to be more willing to vote against the re-election of directors, albeit such instances remain quite rare. Shareholders are particularly concerned at circumstances where they believe that a director has too many commitments. For example the ISS Proxy Voting Guidelines considers it excessive if any director has more than five non-chair non-executive director positions. A director can also run into trouble with shareholders if they are deemed not to be independent, because of tenure or links to a shareholder. Voting sanctions may then be applied to a non-independent director if they sit on a board committee that requires only independent directors, such as the RemCo.

In summary, dialogue with institutional shareholders on governance and remuneration matters has never been more important. Such shareholder engagement on governance and remuneration matters should include both the passive index/quant investors that have grown in importance at the top of the share registers of UK companies, as well as the active investors seen by companies as part of the normal investor relations activity. KMPG Makinson Cowell remains well placed to provide advice to companies on all aspects of the shareholder engagement process.

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