REPORT

Getting Ahead

Governance professionals will now be turning to their company's annual report

Bernadette Young FCG

As we head into 2022, the attention of many governance professionals will now be turning to their company's annual report, how best to deal with disclosure obligations and whether shareholders and other stakeholders will welcome or find fault with the direction their company's governance has taken, with any dissatisfaction often publicly expressed at the AGM.

Organisations across the spectrum increasingly find themselves subject to elevated stakeholder scrutiny with guidelines on reporting and expected standards emanating from diverse sources, including regulators, investor bodies and other providers of capital. Such demands are now, more than ever, backed up by actions intended more robustly to persuade directors to implement change. Keeping up to date with changing expectations and guidance can often feel like a herculean task in its own right. Notable amongst the investor voting guidelines updated for 2021 by organisations such as ISS and Glass Lewis was the predominance of changes relating to diversity, stakeholder engagement, environmental considerations and other ESG expectations.

2022 recommendations are anticipated to follow similar themes, potentially with investors taking a tougher stance on companies not following guidelines. Preparation is key, not just to understand who are the underlying asset owners, but also to learn what agendas are important to them and how they tend to approach any calls for action. In a world where share ownership is often disguised by convoluted nominee and custodian structures, work is needed to gain clarity about who are the real decision-makers if genuine shareholder engagement is not to be hampered. This is an area where obtaining additional and early support should not be dismissed. It will enable active monitoring of votes in the lead up to the meeting so they can be assessed against identified underlying owners, their voting policies and the outcomes of prior dialogue.

Moreover, with a number of organisations now bringing smaller shareholders together to enable collective rights to be exercised (for example to requisition a resolution), the problem may lie amongst a number of retail investors. Their ownership in percentage terms may be minimal, but they still have the right to have their voice heard and organisations which connect them for the express purpose of facilitating shareholder activism increase their potential to punch above their weight and ruffle boardroom feathers.

With COVID, Brexit, rising inflation and increasing taxes creating hardship for many, the perennial issue of executive remuneration is guaranteed to remain a sensitive subject. But with COP26 fresh in our memories and with many market influencers – governments, issuers, asset owners and fund managers – having made substantial promises regarding the effect of their corporate activities on CO2 emissions and climate change, it is not unreasonable to expect that shareholders' key focus in 2022 will be companies' proposed strategies to deal with negative environmental impacts.

Companies will be judged, in particular, on the quality of their climate-related disclosures, including those mandated for companies required to comply with the Taskforce on Climate-related Financial Disclosures (TCFD), and the carbon emission reduction targets they have adopted. Where companies fall short, directors may find investors voting against their re-election and 'say on climate' resolutions. Other alternative strategies to influence companies are also available, however, including the option to sell holdings. Aviva, for example, is just one investment firm to have threatened divestment plans if they perceive companies to be failing to take action.

So this AGM season may perhaps be even more eventful than ever, particularly as it coincides with the first round of mandatory reporting under the TCFD regime for London Stock Exchange premium listed companies. And with draft legislation promising an extension of the TFCD requirements to all listed companies, some AIM companies and other entities with more than 500 employees and turnover in excess of £500m, many other businesses will also soon be in scope.

It is important to remember that, although TCFD is primarily a reporting requirement, the real work is not in preparing the disclosures but in making the changes needed to enable a compelling story to be told. The disclosures need to provide assurance not only that appropriate metrics and targets have been set, but that governance structures are appropriate to oversee climate risks, that the potential impacts on the business, its strategy and finances are understood and that risk management processes are adequate to specifically identify, assess and manage climate-related risks.

With the likely extension of TCFD requirements to a much larger pool of companies and stakeholders increasingly active in influencing companies to demonstrate responsible behaviours in relation to climate and other ESG matters, 2022 will pose a number of practical governance challenges for many organisations.

Advance planning of the resources and support needed to deal with those pressures should start early.

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