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# UK Corporate Update.

## PIRC shareholder guidelines 2014

Pensions Investment Research Consultants, the influential advisory body, has issued the 2014 version of its shareholder voting guidelines. Key concerns this year are "protecting high standards of financial governance and supporting shareholder rights". Unlike some previous years, the latest edition does not contain many new recommendations. However, there are some points which listed companies may wish to bear in mind.

**Share allotment authorities**

PIRC now accepts allotment authorities for "two thirds of the issued share capital for an authority to issue new shares with pre-emption rights" (the 2013 guidelines referred to a limit of one third of the issued share capital). In any case, it appears likely that companies will increasingly move away from seeking allotment authorities equal to two thirds of the share capital and revert to the older one third limit.

**Virtual only shareholder meetings**

In line with the ABI, PIRC considers that it is important to retain meetings in person so that the board can be held to account for their actions and their responsiveness to shareholder concerns. Providing a virtual channel of communication for meetings for shareholders who cannot attend in person can be useful but should not replace the traditional form of meetings.

**Election and re-election of directors**

*Majority controlled companies*

PIRC approves of the proposed changes to the Listing Rules which will require the appointment of independent directors of controlled companies to be approved by a separate vote of the non-controlling shareholders as well as by the shareholders as a whole. At the same time, PIRC is concerned about press reports of current or past directors of companies with difficult governance situations who feel they are at risk of litigation if they speak out. The guidelines emphasise that all directors should act in the interests of the company, rather than trying to protect other directors or certain shareholders.

*Executive directors*

PIRC has dropped last year's statement about shareholders being able to vote on contract policy before appointments of future executives take place. This has been replaced with a recommendation that all vacant posts for executive directors should be formally advertised.

*Information on attendance at board meetings*

PIRC is concerned that committees may be unduly influenced by parties with a vested interest in their decisions and would therefore like to see disclosure of all attendees, including executives and paid advisers, at board and



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committee meetings. In addition, committee terms and conditions should ensure that the committee is not quorate if advisers are present and there are no members present with sufficient understanding of the technical issues being discussed.

**Financial reporting**

Last year PIRC criticised financial and accounting disclosures under the IFRS framework on the basis that they show "distorted" profits which do not give a true and fair view of the company's affairs.

This year it has highlighted that recent cases, such as the Co-operative Bank, confirm this view. In particular PIRC feels vindicated in asserting that with IFRS as the accounting model it is not possible for directors and auditors to confirm whether a banking company is a going concern or not, as this requires an assessment of expected losses which are not recorded or looked for by the auditors. As before, PIRC will recommend that shareholders oppose the adoption of a company's accounts, the re-election of any member of the audit committee or the finance director, where it is clear or suspected that the company's adherence to IFRS has led to a failure of the accounts to provide a true and fair view.

**Shareowner relations**

The guidelines emphasise the responsibilities of investors and that engagement is not a substitute for action. PIRC has observed serious governance flaws at listed companies which have not been the subject of collective action by investors or reported in stewardship reports to beneficial owners. Flaws include: under provisioning for losses; inflated profits; unintelligible executive incentives; control structures which favour minorities; governance of investment trusts by external managers; procrastination on gender bias; rewards for failure; closed-shop recruitment; incompetent directors; unidentified risks; and a narrowing of liabilities and duties.

On the other hand PIRC acknowledges that companies face practical difficulties in ensuring that a satisfactory dialogue has taken place given the conflict between the encouragement of dialogue with shareholders and the need to treat shareholders equally. PIRC thinks that companies should report on how this conflict is managed when conducting such dialogues.

**Directors' remuneration**

PIRC continues to argue that remuneration should be tightly controlled and monitored. This section of the guidelines has been revised to include PIRC's views on compliance with the new disclosure and voting regime for directors' pay and sets out PIRC's additional expectations. A more detailed briefing on the remuneration aspects of the guidelines will follow.

## Review of headhunters' code proposes database of board-ready women

A number of recommendations have been made to improve executive search processes so as to get more women on boards. An independent review conducted by Charlotte Sweeney of the Voluntary Code of Conduct for Executive Search Firms includes best practice recommendations for search firms, companies and investors. The Code was established in 2011 in response to the recommendations of the Davies Review of women on boards.

The review recognises that change can only be brought about by all relevant parties working together. It recommends that:

> Lord Davies' steering group should set up a database of "board-ready" women;

> the Equalities and Human Rights Commission should create guidance on whether women-only shortlists are appropriate;

> Companies should be clear about their commitment to diversity and should challenge their search firms further, specifically by stating in all search contracts that they will comply with the code and explain if unable to do so;

> search firms should put forward female candidates, including at least one strongly-regarded woman on the shortlist for each board vacancy;

> search firms should work together, capture and share relevant information and publicise their commitment to diversity;

> the investor community should take a more active role on this topic and the code should be referenced on the FRC website and within the FRC Guidance on Board Effectiveness, when this is next updated; and

> a section of the BIS website should be dedicated to publicising the executive search code of conduct.

The Davies Review in 2011 set a target of 25% female representation on FTSE boards by 2015. Current figures show that 1 in 5 FTSE 100 directors is a woman (up from 19% in 2013 and 12.4% in 2010).

For a copy of the review click here and for a copy of the Voluntary Code of Conduct for Executive Search Firms click here.

## New guidance for proxy advisors to improve issuer-investor relations

New best practice principles for providers of shareholder voting research and analysis services have been published. Also known as proxy advisors, they review meeting notices, reports and accounts and other publications by listed companies and then report to shareholders on whether the companies comply with best practice. They play an important role in the dialogue between issuers and their investors. The new principles should promote higher standards, greater consistency and increased transparency for both investors, who rely on their research when making voting decisions, and issuers, who may now find it easier to engage with such advisors.

### The principles

The principles have been prepared on behalf of a group of corporate governance research providers, the Best Practice Principles Group, following a recommendation by the European Securities and Markets Authority. They include the following recommendations.

> Proxy advisors should publicly disclose their research methodology and, if applicable, house voting policies (such as the PIRC shareholder guidelines). The disclosure of house voting policies should include the extent to which local standards, guidelines and market practices are taken into account and the extent to which issuer explanations on deviations from comply-or-explain corporate governance codes are taken into account.

> Proxy advisors should publicly disclose their policies for communication with issuers, shareholder proponents, other stakeholders, media and the public. The policy for dialogue with issuers, shareholders, other stakeholders and their advisors should include the circumstances under which such communication could occur; how proxy advisors verify the information used in their analysis; and whether issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication.

- Shareholder voting research and analysis should be relevant, accurate and reviewed by appropriate personnel prior to publication.
- Proxy advisors should ensure adequate verification (which may include issuer fact-checking).
- The disclosure of research methodology should include the general approach that leads to the generation of research, the information sources used, the extent to which local conditions and customs are taken into account, the extent to which custom or house voting policies or guidelines may be applied and the systems and controls deployed to reasonably ensure the reliability of the use of information in the research process, and the limitations thereof.
- Proxy advisors should publicly disclose a policy that details their procedures for addressing potential or actual conflicts of interest that may arise in connection with the provision of services.

**Who is subject to the principles?**

The principles operate on a comply-or-explain basis. Signatories to the principles should publish a link to a statement of compliance with the principles on the BPPG website and review it at least annually.

The BPPG will perform on-going monitoring of the implementation of the principles and will review the principles and guidance no later than two years following their launch. ESMA will perform a separate review of the implementation of the principles and their monitoring by the BPPG at the beginning of 2016.

Members of the BPPG, and the first signatories to the principles, are Glass, Lewis & Co, Institutional Shareholder Services Inc, IVOX GmbH, Manifest Information Services Ltd, PIRC Ltd and Proxinvest.

The Best Practice Principles for Shareholder Voting Research 2014 are available here.

## Enforcement of security over shares has Takeover Code consequences for lender

A lender which enforced its security over shares in a public company has been forced by the Takeover Panel to sell those shares because it was a concert party of another shareholder who already held more than 30% of the company. The Panel also placed restrictions on the exercise of voting rights pending the sale, but did not insist on a mandatory cash offer being made for the company under Rule 9 of the Takeover Code. This is a useful practical illustration of the Takeover Panel's approach to such matters.

**Facts**

- Opportunity Investment Management plc is a company within the scope of the Takeover Code.
- Mercurius Beleggingsmaatschappij BV, a 30.13% shareholder in OIM, assigned the benefit of a loan it had made to another shareholder of OIM to Budeste Maastricht BV.
- The shares in OIM held by the borrower were charged as security for the loan. The borrower subsequently defaulted and Budeste enforced its security.
- The enforcement action resulted in Budeste acquiring a 14.7% shareholding in OIM whilst Mercurius held a stake of over 30%. Budeste later disposed of some of the shares resulting in a shareholding of 12.88%.

**Panel decision**

> The Panel reviewed the relationship of Mercurius and Budeste, the circumstances of the assignment of the loan, and the subsequent acquisition by Budeste of the OIM shares. It regarded Mercurius and Budeste as acting in concert at the time of the acquisition as well as subsequently.

> The Panel did not require Mercurius or Budeste to make a mandatory cash offer for OIM under Rule 9 of the Takeover Code. Instead, the Panel ruled that the aggregate percentage of OIM shares carrying voting rights in which Mercurius and Budeste, and any of their concert parties, were interested, must be reduced to 30.13% (the original level of shareholding of Mercurius) by way of disposal of OIM shares (under Note 2 of the Notes on Dispensations from Rule 9).

> The Panel also ruled that, pending such disposal, the aggregate number of votes that could be exercised at any OIM general meeting by Mercurius and Budeste, and any of their concert parties, must not exceed 30.13% of the votes exercisable at such meeting.

Click here for the Takeover Panel's ruling.

***Takeover Code reminder***

Rule 9.1 of the Takeover Code states that, except with the consent of the Takeover Panel, when any person, together any concert parties, is interested in shares which carry not less than 30% of the voting rights of a company but does not hold shares carrying more than 50% of such voting rights and such person, or any concert party, acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which he is interested, such person shall make a mandatory cash offer for the company.

However, the Takeover Code provides that, where shares are charged as security for a loan and, as a result of enforcement, the lender would otherwise incur an obligation to make a mandatory cash offer, the Takeover Panel will not normally require such an offer if sufficient interests in shares are disposed of within a limited period to persons unconnected with the lender, so that the percentage of shares carrying voting rights in which the lender, together with any persons acting in concert with it, is interested is reduced to the percentage held by those persons prior to the triggering acquisition being made (Note 2 of the Notes on Dispensations from Rule 9). In giving its consent, the Takeover Panel will require that, until such time as the interests in shares are disposed of, appropriate restrictions are imposed on the exercise of voting rights attaching to the shares in which the lender or persons acting in concert with the lender are interested.

## UK Merger Control Reforms: The Essentials

From 1 April, in the context of a series of wide-ranging reforms to the UK competition regime, the UK's two competition bodies, the Office of Fair Trading (OFT) and the Competition Commission (CC), will be replaced by the new Competition and Markets Authority (CMA). In our "cheat sheet" we take a closer look at some of the key reforms to the UK merger control regime. It is important to note that the new rules may apply to deals which have already signed or indeed completed before 1 April.

Read our "cheat sheet" now

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