AllianceBernstein

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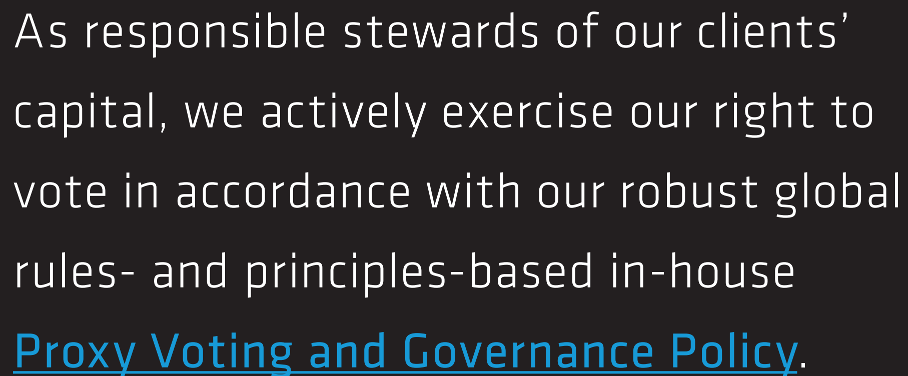
Corporate Governance Trends Overview

UK/Ireland, Netherlands and France



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Introduction

Across Europe, there have been significant developments regarding the introduction of new regulatory requirements for board-level gender diversity. Not only have the UK, Ireland, France and the Netherlands adopted new gender diversity requirements, but in June of this year, the European Union agreed on a historic deal requiring at least 40% of non-executive board seats to be held by the underrepresented gender, beginning in 2026. These increasingly rigorous regulations will likely result in more diverse boards across Europe in the next few years as issuers seek to comply.

In addition to the changing gender diversity landscape, executive remuneration is being increasingly scrutinized by institutional investors, as compensation begins to return to pre-pandemic levels. And in European markets, a notable number of Say on Climate (SoC) proposals are being put to a shareholder vote. There are also higher levels of dissent on SoC proposals, which suggests a potential disconnect between shareholder expectations and the rollout of companies' climate risk strategies.

In the UK, there has been significant reform to audit and corporate governance rules, the most notable being the replacement of the Financial Reporting Council (FRC) with a new and more powerful regulator, the Audit, Reporting and Governance Authority (ARGA). The UK market has also revised the listing rules to encourage growth companies to list in the country.

What follows is an overview of significant developments in the UK/Ireland, the Netherlands and France regarding themes such as gender diversity, executive remuneration, climate and corporate governance.

UK/Ireland

Executive Remuneration

During the 2022 proxy season, companies in the UK saw heightened scrutiny of executive remuneration due to inflation and the increased cost of living in the country. Simultaneously, there was a return to near-maximum bonus payouts as defined by compensation plans, as most bonus targets were established in the spring of 2021 and corporate profits have surged since. Gains resulting from recovering share prices may also impact many of the 2020 long-term incentive plans that vest next year. The general return to higher levels of executive pay across the UK has widened the pay gap between management and the broader workforce, which is a reversal of the previously observed trend that showed this gap closing before the COVID-19 pandemic. Retail and hospitality are the industries most impacted in the UK due to low overall pay across the broader workforce. Tesco, a groceries and general merchandise retailer, is one example of this increased pay disparity, with a chief executive officer (CEO) pay ratio of 224:1.

J Sainsbury, the second largest chain of supermarkets in the UK, received a shareholder proposal coordinated by the shareholder advocacy nonprofit ShareAction as part of the latter's living wage campaign Good Work Coalition, which seeks to improve working conditions and focuses on a living wage. The resolution asked Sainsbury's to become accredited by the Living Wage Foundation, which would force the company to pay all its independent third-party contractors (not just employees) a "real living wage."[1] Importantly, Sainsbury's already pays its employees and most of its contractors a living wage; the company explained in a letter to shareholders that all Sainsbury's and Argos store colleagues are receiving an hourly base rate of at least £10 per hour, which is 50p above the government's National Living Wage and 10p above the Living Wage Foundation's Real Living Wage. As a result, we voted against the resolution, although we support the spirit of the request.

Ireland poses an interesting case to consider with regard to a blanket cap on executive pay, as banks are prohibited from providing any variable pay to executives. No benefits, incentive schemes or allowances can be implemented without first obtaining permission from the minister of finance. This restriction stems from the banking crisis in 2007 and has raised notable talent retention concerns for the Bank of Ireland Group in 2022. After the bank announced in September 2021 that chief financial officer (CFO) Myles O'Grady would be leaving, the chair of the Bank of Ireland Group, Patrick Kennedy, raised the issue in the bank's 2021 annual report, stating in his opening letter that "the remuneration restrictions which apply to Bank of Ireland are not replicated in any market in which the Group does business, creating an uneven playing field between the Bank and all other corporates." To attempt to address these concerns over talent retention, in February 2022 the bank agreed to a pay deal recommending a 7.5% increase in performance-linked salary. Despite this, in April 2022 CEO Francesca McDonagh also announced that she would be leaving due to the restrictions on executive pay.

Climate

Climate was a key theme of the 2022 proxy season in the UK and Ireland, with a record number of SoC proposals being put to a vote: AB voted on 13 SoC proposals in 2Q:22, compared with only four last year in the region. Since 2021, UK companies have been executing their climate risk plans and emissions-reduction goals and are seeking Science Based Targets initiative (SBTi) approval of their strategies. SBTi, however, has not finalized the industry standards for fossil fuel companies, which presents a significant challenge to institutional investors, as the largest global emitters are oil and gas names. A third-party verification of these companies' climate goals would help investors determine the extent to which their climate risk plans are aligned with the Paris Agreement.[2]

In the UK in 2022, support for climate plans was relatively lower than last year, with a significant amount of dissent at some of the largest companies: 11.5% of shareholders voted against BP's SoC, and 21% voted against Shell's. In the 2022 season, it was common at UK companies for around 20% of shareholders to vote against climate plans. It is likely that these reduced levels of shareholder support reflect higher expectations for more ambitious emissions-reduction goals as well as for overall plan transparency. A growing number of stakeholders are also placing more emphasis on the inclusion of Scope 3 emissions in UK companies' climate strategies.[3] This may also have contributed to the increased levels of dissent. Despite wider shareholder discontent with UK issuers' climate risk strategies, AB supported 100% of SoC proposals in the UK in 2Q:22. (AB also supported 100% of SoC proposals in the UK in the 2021 season.)

1 The Real Living Wage is independently calculated based on what people need to meet their cost of living. It is the only UK wage rate that is voluntarily paid by over 10,000 UK businesses. Living Wage Foundation, "What Is the Real Living Wage?"

2 The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 parties at COP 21 in Paris on December 12, 2015, and entered into force on November 4, 2016. Its goal is to limit global warming to well below 2 degrees Celsius, preferably to 1.5 degrees, compared with pre-industrial levels. United Nations Climate Change, The Paris Agreement.

3 Scope 3 emissions are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain. EPA Center for Corporate Climate Leadership, Scope 3 Inventory Guidance.

Shell

While a substantial number of shareholders voted against the SoC proposal at Shell, we believe the company's strategy is sufficiently aligned with the Paris Agreement and includes rigorous and transparent interim emissions targets. Shell's disclosures are in line with the Task Force on Climate-related Financial Disclosures (TCFD) framework, and the company has added two committees to its existing governance structure to assist in the oversight and development of the plan: the Capital Investment Committee and the Carbon Reporting Committee. While Shell's use of intensity reduction targets for Scope 3 emissions rather than absolute reduction targets is a valid concern, it is not standard in the industry for issuers to include Scope 3 emissions reduction targets in their climate strategies, especially not absolute targets. Similarly, another apprehension with the proposed plan was Shell's partial reliance on nature-based offsets and carbon capture and storage. While it is optimal for issuers to minimize their use of carbon offsets in their climate risk strategies, most large oil and gas companies currently rely on offsets to some extent to achieve their reduction goals. It is also worth considering that, despite the justified criticism of Shell's industry associations for lobbying against the Paris Agreement, the company is relatively advanced in terms of overseeing its indirect lobbying dollars, as it categorizes the trade associations it is part of in terms of their alignment with its climate goals.

Gender and Ethnic Diversity

Beginning in April 2022, the Financial Conduct Authority (FCA) established a new set of gender diversity targets for publicly listed UK issuers: At least 40% of the non-executive board should be women, and at least one of the senior board positions (chair, CEO, CFO or senior independent director) should be a woman. In addition, no fewer than one member of the board should be from an ethnic minority background, excluding white ethnic groups. The FCA has also proposed disclosure obligations regarding the ethnic makeup of boards and executive management. If companies are unable to comply, they must provide a rationale. Mandatory reporting will begin in 2023, although companies are encouraged to voluntarily disclose their management-level gender and ethnic diversity before next year. As these rules take effect, we expect to observe a positive trend toward more diverse boards across publicly listed UK companies.

Audit Reform

In the wake of several corporate collapses in the UK resulting from ineffective audit processes, the government has established a plan to overhaul audit and corporate governance rules. The government elected not to pursue more radical reforms such as proposals that require directors to sign off on internal controls and financial auditing, which would have dramatically increased director accountability. Instead, a provision was added to the corporate governance code that only applies to the largest publicly listed companies that can opt out with a sufficient rationale. Another proposal, which was similarly dropped, would have required the big four audit firms—Deloitte, Ernst & Young (EY), KPMG, and PricewaterhouseCoopers (PwC)—to split their audit functions off from their primary business. Interestingly, even though the UK government is not pursuing the proposal, EY decided to split off its audit and advisory businesses.

One of the most significant impacts of the reform package is the replacement of the FRC with a new and more powerful regulator, the ARGA. This transition is set to take place in April 2023, and is intended to result in stronger enforcement capabilities and a greater degree of oversight than before. In addition, the government intends to expand the definition of public interest entities (PIE) to ensure that large businesses of public importance are subject to more stringent regulation and oversight. The revised PIE scope will include large companies with both 750 or more employees and an annual turnover of at least £750 million. The new definition will also include companies that are traded on multilateral trading facilities such as AIM (formerly the Alternative Investment Market), as well as private limited companies, only if they reach the aforementioned threshold. With this revision, roughly 600 new entities will be brought into the expanded PIE universe.

Updated Listing Rules

In April 2010, the Financial Services Authority (now the FCA) relabeled the existing two-tier listing regime—primary and secondary listings—with premium and standard listings for UK public issuers. Premium listed companies must comply with super-equivalent regulations that exceed those of the standard segment. On December 3, 2021, the FCA updated the listing regime to

encourage growth companies to list in the UK. The previous listing rules were perceived as potential barriers to entry, so the FCA amended the requirements to list as a premium issuer.

The first change was to reduce the free float requirements (the amount of equity a company must have in public hands) from 25% to 10%. The FCA argued that this change would remove the perceived barrier to listing in the UK without significantly sacrificing liquidity. The second amendment was to allow issuers (excluding funds and controlled commercial companies) to maintain dual class share structures upon listing in the premium segment. These share classes can have standard, or in some cases weighted, voting rights of up to 20 votes per share. These enhanced voting rights may only apply to shareholder proposals to remove directors, or following a change in control, any shareholder resolution. Furthermore, the voting rights may only be maintained for five years after listing, which provides issuers with an opportunity to grow with some degree of defense against hostile takeovers. The previous rule only allowed for this dual class structure at standard listed companies. The third change made by the FCA was to increase the required market capitalization for premium listed issuers from £700,000 to £30 million, which is a vast increase, but falls short of the £50 million that the FCA originally proposed. This requirement does not apply to companies that are already listed in the premium segment, but only to newly listed or relisted issuers. We expect these updated listing rules will result in an increase in the number of companies that are able to attain a premium listing in London. For companies that are unable to comply with the updated requirements of premium listings, the standard segment remains a more easily attainable option.

Netherlands

Gender Diversity

As expected, gender diversity has been a point of emphasis in the Dutch market in 2022. On September 28, 2021, the Dutch parliament approved the Act on Gender Balance on Management and Supervisory Boards, which established a firm gender quota for companies in the Netherlands: the Act requires that boards be composed of at least one-third male members and one-third female members. The Act also clarifies that any appointments to boards in 2022 and after that do not contribute to improved gender diversity are null and void. However, exceptions can be made for the reelection of directors within eight years of their appointment, as well as for extenuating circumstances.

In addition, the Act requires large public and private limited Dutch companies to establish ambitious gender balance targets both for their board of directors and their supervisory boards. Furthermore, large companies must formulate a strategy to achieve their gender diversity goals (such as changes to the recruitment process, board size, etc.) and annually report on their progress. The Act defines large organizations as those that achieve two or more of the following criteria over a two-year period: a balance sheet of over €20 million, net turnover of more than €40 million and 250 or more employees averaged over the financial year. This includes an estimated 5,000 companies. The Dutch Social and Economic Council will monitor and assess the impacts of the Act, which is subject to a sunset provision after eight years.

Executive Remuneration

Executive remuneration proposals have encountered significant opposition in the Netherlands over the past few years, with the notable example of AkzoNobel's rejected remuneration report in 2021. While the number of executive compensation proposals remained roughly the same year over year, AB supported only 61% of the executive compensation proposals in 2Q:22 versus 70% in 2Q:21. This was largely because Dutch companies still maintain relatively low levels of disclosure for both short-term incentive (STI) and long-term incentive (LTI) performance conditions, despite a general increase in proposed pay as profits rebound from the pandemic. The combination of these two factors has often led to misaligned pay and performance. As the Shareholder Rights Directive II legislation continues to impact remuneration standards across Europe, we are hopeful that companies in the Netherlands will improve their disclosure of performance criteria and in doing so provide investors with an opportunity to better assess the ties between compensation and the shareholder experience.

This season, Koninklijke Philips received the highest level of dissent on a remuneration proposal, with almost 80% of votes cast against the plan. This lack of shareholder support was primarily because the company used discretion to adjust its STI and LTI outcomes despite losing 44% of its market capitalization due to product recalls related to life-threatening quality issues in its continuous positive airway pressure (CPAP) machines.[4] The company cited supply-chain issues as a rationale for the adjustments, which caused a material misalignment between pay and performance.

DSM, a multinational corporation focusing on health, nutrition and materials, has market-leading remuneration practices that are worth highlighting. The company's STI plan balances well its disclosed financial and nonfinancial performance metrics, and its LTI plan gives equal weight to energy efficiency, greenhouse gas emissions, relative total shareholder return and return on capital employed. By using meaningful and quantifiable climate metrics, DSM can directly tie its executive compensation to its progress on environmental sustainability. While this is not common market practice, we hope to see more Dutch companies adopt this leading approach to remuneration in the next few years.

4 A CPAP machine provides air at a pressure just high enough to prevent the collapse of a person's airway. Mayo Clinic, "How CPAP Controls Sleep Apnea."

While a majority of publicly listed issuers in the Netherlands provide variable compensation to their executives, the 2015 Financial Supervision Act prohibits variable payment to executives in cases where the state is a shareholder of the company. ABN AMRO falls within this national law, but still provides individual- and organizational-level key performance indicators for its executives to internally monitor their performance. As a result, AB voted in favor of the company's remuneration report.

Unequal Multiclass Share Structures

In 2022, AB began holding companies responsible for maintaining multiclass share structures with unequal voting rights, as this is frequently used as a board entrenchment tool. By giving certain share classes higher voting rights than one vote per share, companies can limit the ability of minority shareholders to have meaningful impacts with their votes. In the Dutch market, however, it is common practice to issue preference shares as an anti-takeover mechanism. In the Netherlands, when a hostile shareholder or bidder seeks to seize control of a publicly listed company, this issuance of preference shares (called a call option right) goes to a target-friendly Protective Foundation that exists to defend the interests of the company by diluting the equity of all other shareholders to less than 50%. As a result of this market-specific context, we have given a pass to multiclass share structures that stem from this common market practice in the Netherlands.

France

Corporate Governance

In France, the Association Française des Entreprises Privées (AFEP) is the main lobbying group for large private-sector French companies, and the Mouvement des Entreprises de France (MEDEF) is the largest network of employers. Together the two organizations have developed the AFEP-MEDEF Code, the predominant corporate governance code for publicly listed French companies, which contains recommendations on best practices for large-cap issuers. The Autorité des Marchés Financiers (AMF) is responsible for the oversight and regulation of French issuers. Every year, the AMF publishes a report on corporate governance in France and provides general recommendations based on its observations, which are not formally codified into law, but which companies are expected to follow.

In its 2021 Report on Corporate Governance and Executive Compensation in Listed Companies, the AMF highlighted a recent positive trend in the separation of the chair and CEO roles at French companies. The increased separation of these two roles is a meaningful change in best practice. The AMF further pointed out that in the case of companies that have chosen to maintain the combined CEO/chair role, the companies are generally implementing the necessary checks and balances, such as appointing a lead independent director to manage potential conflicts of interest, establishing a clear succession plan and holding at least one annual meeting without the CEO/chair.

The AMF's 2021 report also underscored that one of the most prevalent issues with executive remuneration in France is boards' use of discretion to adjust performance outcomes. Throughout the pandemic, French issuers frequently adjusted variable pay both upward and downward, resulting in significantly altered payouts to executives. Discretionary adjustments without mitigating factors such as lowered pay opportunity amid extraordinary circumstances, can be problematic, as they undermine the connection between pay and performance in the original plan. Regardless of the adjustment, the "explain or comply" rule requires French issuers to provide a detailed rationale to justify their use of discretion to ensure there is adequate dialogue with shareholders. It is our hope that as companies rebound from the impacts of the pandemic and as best practice continues to improve, French companies will decrease their use of discretionary adjustments to compensation.

In France, it is common for publicly listed companies to be family controlled. This includes some of the largest French companies: LVMH Moët Hennessy Louis Vuitton, Peugeot, Auchan and L'Oréal, to name a few. Family control presents several risks and agency issues that may not be present in other companies. Family-controlled companies often appoint directors from within the family, who may not be subject to a prior assessment of qualifications and contribute to lower levels of board-level independence. There are generally less effective internal and external control mechanisms at family-controlled companies due to family ties between parties and strong control of the company. These companies also often face issues with excessive executive remuneration, and business decisions are not always made with the goal of increasing shareholder value. Many of the risks associated with family control can, however, be mitigated by adhering to strong corporate governance practices. These practices include maintaining majority-independent boards and key committees, appointing independent lead directors and establishing transparent remuneration policies with rigorous performance metrics.

ORPEA Group

On January 26, 2022, Victor Castanet published a book titled *Les Fossoyeurs* that accused the care homes owned by ORPEA Group of malpractice. Most notably, Castanet argued that the company's culture prioritized reducing costs and "cutting corners," decreasing the quality of living conditions for the elderly. Examples included negligence leading to death, and a patient's death being "accelerated" without family consent. There were also allegations of wrongful terminations, illegal profits, collusion with state entities, tax fraud and more. Six days after the book's publication, the company's board announced the termination of Yves Le Masne

as CEO and the appointment of Philippe Charrier, non-executive chairperson, as chair/interim CEO. The French government and two audit firms then launched investigations into malpractice, and Mirova, a 3.9% shareholder, sent a letter to the board proposing an enhanced Corporate Social Responsibility (CSR) Committee role, the nomination of an independent vice CEO and full transparency related to the crisis.

At its annual general meeting in July, ORPEA Group suggested a vote against the compensation of Yves Le Masne, to deny the former CEO any variable compensation (limiting his pay to a fixed salary), and 2021 LTI awards were forfeited due to his termination. The proposed compensation for Philippe Charrier would allow him to receive exceptional remuneration capped at 100% of salary, which was vaguely disclosed and could lead to unjustified payments. Moreover, the grant of exceptional pay could be viewed as inappropriate given the company's circumstances. As a result, AB voted against both the former and current CEO's compensation.

Gender Diversity

In December 2021, France adopted Law 2021-1774, known as the Rixain Law. The new law—which seeks to bolster existing gender diversity requirements and intensify reporting obligations, especially for senior executives—will gradually enter into effect from 2022 to 2029. As of March 2022, companies with 1,000 or more employees are required to publish statistics annually on the percentage of men and women in senior management and board management positions. By March 1, 2027, women must hold at least 30% of board and senior management positions. This will be raised to 40% in 2030. Companies that fail to comply with this new regulation must publish corrective measures on their website. We do not expect this law to have a significant impact on board-level gender diversity for the next few years given the relatively long time frame, although French companies already often make board-level gender representation a criterion for STI and LTI plans.

In addition to the Rixain Law, the 2021 MiddleNext Corporate Governance Code, directed at small- and mid-cap companies with a major or controlling shareholder, recommends that companies form a CSR Committee and establish a balance of gender diversity at every level. This is the first French code to recommend an independent chair for all key committees. The code also urges French companies to include well-disclosed nonfinancial performance metrics in variable pay.

Climate

During the 2022 proxy season, AB voted on a record 10 SoC proposals in France, compared with three in 2021. Notably, our support for management-slated climate risk proposals decreased from 100% in 2021 to 80% this year. The primary reason for this is due to the increase in the number of SoC proposals being put to a shareholder vote. The two "against" votes cast on SoC were at Mercialys and Nexity Financial, both of which are large French real estate development companies. In both instances, AB voted in favor of the proposals.

In the case of Mercialys, the company's climate transition plan is not adequately aligned with the TCFD recommendations and the Paris Agreement. The company aims to achieve net zero by 2030, but has not formally committed to this goal. Additionally, the plan has short- and mid-term targets but lacks a long-term strategy. Mercialys also already achieved its employee commute and waste management emissions reductions in 2019 and 2018, respectively, which calls into question the relevance and rigor of these targets.

Similarly, Nexity's climate transition plan fails to commit to net zero by 2050 or earlier and does not report emissions in line with TCFD recommendations. Further, the company has not committed to an annual shareholder vote on its plan, which undercuts the ability of shareholders to monitor the company's progress regarding climate risk mitigation. In addition, the plan lacks short- and long-term targets, making it difficult to assess the rigor and scope of the company's strategy.

A significant vote in favor of a French climate risk resolution came from TotalEnergies, one of the seven supermajor oil companies. Its SoC plan received about 89% support from shareholders, compared with 92% in 2021. TotalEnergies has committed to reaching net-zero emissions by 2050, and the company's Sustainability and Climate Transition Plan is broadly aligned with both market practice and the Paris Agreement. The overall disclosure is aligned with the TCFD framework, and the interim targets are clearly described, in our view. TotalEnergies also has a meaningful governance structure in place to oversee the execution of the plan, including consistent board oversight in partnership with the Strategy and CSR Committee, discussions with the executive director of the International Energy Agency, and a climate training program for all directors. To incentivize executive management to achieve the goals set out in the plan, the company has included climate-related performance metrics in its annual bonus and LTI plans.

Florange Act

The Florange Act, which was adopted in March 2014, impacts the one-vote-per-share principle and anti-takeover measures for French companies. The Act introduced "loyalty" shares or "time-phased" voting shares, which automatically grants double voting rights to shares held in registered form by the same shareholder for more than two years. Companies can choose to opt out of the Act with shareholder approval or prohibit double voting rights in their company bylaws. Importantly, the Florange Act also gives the board the ability to adopt any provisions necessary to thwart a hostile takeover without shareholder approval. Companies could choose to opt out of this provision through bylaw amendments as well.

AB began voting against relevant committee/board members for multiclass share structures with unequal voting rights in 2022, and we include double voting rights in this approach. If French companies choose not to opt out of the loyalty share structure, we will hold the board accountable, because this structure can undermine the rights of minority shareholders. In addition, we generally vote against any share issuances with or without preemptive rights if they can be used as a takeover defense without shareholder approval.

Conclusion

This was a landmark year for gender diversity across Europe. As the various regulatory requirements are implemented over the next few years, we expect to see European companies steadily improve their board-level gender diversity to comply with the improved minimum thresholds. Broadly speaking, in Europe in 2022 both executive remuneration proposals and SoC proposals have seen an increased degree of scrutiny from institutional investors. European issuers will need to have robust and transparent discussions with shareholders to better align their compensation and climate risk mitigation practices with shareholder expectations if they are to avoid significant levels of dissent on these proposals moving forward.

What May Be Expected in 2023

In 2023, we expect the number of SoC proposals to continue to increase across Europe as more companies consider their role in the transition to net zero. We also expect some issuers will improve the rigor and disclosure of their SoC plans as we get closer to 2030, to ensure alignment with the Paris Agreement. In the UK, we expect the expanded definition of PIE could require a higher number of UK companies to comply with more stringent regulations. This will likely occur alongside an increased number of publicly listed UK issuers, following the revised listing rules.

Predisclosed Vote Intentions

As part of our engagement and stewardship efforts, AB publishes our vote intentions on certain proposals in advance of select shareholder meetings, with an emphasis on issuers where our discretionary managed accounts have significant economic exposure. The selected proposals are chosen because they impact a range of key topics where AB may have expressed our viewpoints publicly, through prior engagement or proxy voting, or are relevant to AB's historical and current RI initiatives. We do not predisclose our vote intentions on mergers and acquisition activity.

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