Grant Thornton

Corporate Governance Review 2020

Key observations on Code adoption

59%
declare compliance with 2018 Code provisions, down from 73% for the old Code

32%
discuss the application of the Code principles in a meaningful way

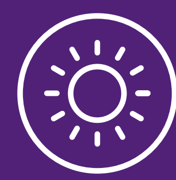
6%
measure the impact of their corporate purpose

38%
provide detailed section 172 statements

51%
give no information about sources they use to assess culture

30%
state how they mitigate emerging risks

A quarter of companies anticipated the risk of a major event like COVID-19



27%
say environmental risks are a principal threat while only 10% use climate change or other environmental metrics in executive remuneration

25%
have had their chair on the board for more than nine years

51%
provide good or detailed explanations of board evaluation, but only 46% give sufficient detail on outcomes

Methodology

This review, now in its 19th year, comprises a comprehensive analysis of the annual reports of the companies in the FTSE 350.

It assesses compliance with:

- the disclosure requirements of the UK Corporate Governance Code 2018
- the narrative reporting requirements set out in S414c of the Companies Act 2006, as amended.

As well as assessing compliance with the Code, the review considers the application, namely quality and detail of explanations, and draws attention to best practice and emerging trends in narrative reporting.

This year's review covers 281 FTSE 350 companies (as of March 2020) 99 from the FTSE 100 and 182 from the FTSE 250, with years ending between April 2019 and April 2020. In 2019, our data covered 288 companies: 100 from the FTSE 100 and 188 from the FTSE 250.

In our sample 72 FTSE 350 companies reported against the 2016 Code, 209 companies against the 2018 Code; 17 FTSE 100 companies reported against the 2016 Code, 82 companies the 2018 Code; 55 FTSE 250 companies reported against the 2016 Code, 125 companies against the 2018 Code.

Our analysis excludes investment trusts, as they are able to follow the AIC Code of Corporate Governance. Full details of the questions can be provided on request from Alex Worters.

Simon Lowe would like to thank: Jide Ajomale, Gabriella Demetriou, Tedi Jorgji, Yaryna Kobel, Filipa Santos and Alex Worters from Grant Thornton.

Viewpoints
Simon would also like to give special thanks to Leon Kamhi, Head of Responsibility, International business of Federated Hermes, Amanda Mellor, Group Company Secretary at Standard Chartered Bank, Andrew Ninian, Director, Stewardship and Corporate Governance at The Investment Association, and Maureen Beresford, Head of Corporate Governance and David Styles, Director, Corporate Governance and Stewardship, from the Financial Reporting Council, for providing their contributions for this year's review.

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Foreword

Simon Lowe
Chair, Grant Thornton Governance Institute

Sarah Bell
Partner, Governance and Board Advisory

For almost two decades, our Corporate Governance Review has tracked how the reporting of applied governance practices has evolved among FTSE 350 companies – examining how companies have shaped business models, cultures, and decision-making structures, to drive results over a sustained period.

This year, COVID-19 has presented a challenge to companies finalising and reporting their results – however, it is also acting as a catalyst forcing companies to review legacy structures that have potentially encumbered agile decision making, and to test their purpose and the role they play in wider society. At the macro level, there is a growing sense of connection between society, business, and government, with companies bearing wider responsibility. This is challenging the historical primacy of the shareholder and increasing the need for transparency and trust between business and wider stakeholders, intensifying the spotlight on the value companies create for stakeholders beyond profits.

Annual accounts are still the single, most reliable source of information about the purpose of a company, its business model, its value proposition, and performance. So, the quality of corporate reporting remains a key indicator of a board's leadership style, commitment to transparency and its sense of accountability to stakeholders and society.

In this, our 19th annual Corporate Governance Review, we cover the adoption of the new UK Corporate Governance Code[1] (the Code) – which seeks to shift focus away from the mantra of 'comply or explain' towards how companies apply the Code's main principles; an established, but perhaps overlooked, requirement of the listing rules.

This year, we find encouraging evidence of companies which have responded well to the transition, using the Code as a blueprint to adapt, evolve and embed new approaches to governance. In the coming years, it will be interesting to see whether those who were quick to adopt changes and embed best practice were more resilient – and able to deliver sustainable outcomes in this unprecedented trading environment.

Our research this year also shows substantial improvements in areas affected by other new reporting requirements, such as the Companies (Miscellaneous Reporting) Regulations 2018. We have seen notable changes in areas such as stakeholder considerations and risk management, in particular looking beyond the immediate horizon. But some areas – such as succession planning, internal controls, remuneration, and integrating climate change and ESG into the business model – clearly need more time to embed in order to demonstrate accountability.

It should be noted that the Code merely distils best practice which has evolved over the years. Our extensive research last year[2] confirmed the correlation between the best governed companies and long-term, sustained value creation.

We hope that the trends and emerging practices we identify in this review will encourage organisations to reflect on their governance practices; revisit the principles and provisions in the new Code; and use their annual report to explain how governance supports the delivery of their purpose, strategy and the creation of value for stakeholders.

1 The UK Corporate Governance Code, FRC, July 2018. www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF
2 7 'Getting smart about governance', Grant Thornton, July 2019. www.grantthornton.co.uk/gettingsmartaboutgovernance

Key findings

Making the transition to the new Code

This year has seen a significant drop in compliance rates, with 59% of companies now claiming full compliance with the new Code, compared to 73% against the old Code last year; a few companies with pre-December year-ends (72 companies) were not required to adopt the new Code – their compliance rate with the old Code is 61%.

In the new Code, the Financial Reporting Council (FRC) has shifted the focus from the mantra of 'comply or explain' towards how companies apply the Code's main principles – an established, but perhaps previously overlooked, requirement of the listing rules. Fifty-six percent provide at least some sort of statement on applying the principles, yet only 32% discuss it in a meaningful way – so whether referring to the old Code or the new one, we see no progress in this area.

Business purpose

The new Code places much more focus on company purpose, namely the principle that clarity of purpose drives longer-term strategic clarity for stakeholders. This year, 82% clearly articulate the reason for their existence beyond profit (2019: 50%). Yet in a large number of companies, the purpose reads like an extended mission statement – drafted to tick the section 172 box of 'wider purpose', but lacking a convincing articulation of what purpose means for how the business is run and makes decisions, offering little insight on measuring success. In fact, just 6% measure progress against their corporate purpose.

Culture

The role of boards and senior management in defining, embedding and monitoring purposeful culture is a continued area of focus for the FRC and the Financial Conduct Authority (FCA)[3]. As with purpose (above), there are encouraging findings in respect of culture: 49% of the FTSE 350 provide good or detailed accounts of their company culture (2019: 45%, 2018: 33%).

More companies are considering how corporate culture contributes to value creation; for example, by promoting co-operative or sharing cultures, improving attitudes to health and safety, engendering employee respect and retention, and improving customer service in an effort to build loyalty.

But there is more of a challenge when it comes to assessing and monitoring culture. Though 83% say that they monitor culture, they seem to use often limited and repurposed sources of information – mostly employee surveys. Fifty-one percent do not explain what sources of information they use to assess culture, nor whether they have a formal process. Only 27 companies say they use a dashboard or scorecard of three or more metrics. At the same time, just 6% of companies use culture related metrics in executive annual bonuses and 3% in their long-term incentives.

Emerging risks and viability

Reporting on principal risks has been one of the successes of modern-day governance, with 84% of companies now providing high-quality risk disclosures, including 36% who offer detailed descriptions (2019: 31%). High-quality disclosures clearly showcase risk trends and how these are managed; these may provide upside opportunities by painting a picture of a company's resilience. Businesses increasingly link risks back to company strategy, providing a better picture of management considerations and the opportunities and threats which affect the achievement of strategy. But there remain areas for improvement: while 73% of the FTSE 350 link risks to strategy, only 18% give meaningful explanations.

While we have seen the quality of risk reporting strengthen over the years, COVID-19 has brought into question whether risk identification processes are challenging enough, when looking beyond the immediate horizon. The evidence of COVID-19 suggests that an element of complacency may have crept in. Only 24% identified COVID-19 and other similar exceptional incidents among the main threats to their business, and that they have put in place appropriate mitigating actions to address this threat. Only 18% of companies with 2019 year-ends identify unexpected incidents such as pandemics as a principal risk – but, with the benefit of hindsight, 53% of companies with 2020 year-ends do so.

Emerging risks are a theme of the new Code. Eighty-nine percent of companies say they assess these risks (2019: 64%), but there is work to do. Most those who assess the issue focus on procedures and processes for identifying risks, rather than outlining what their emerging risks are and how they will manage them, with only 30% indicating how they will mitigate emerging risks.

This year, more companies (68%) provide good and detailed viability statements (2019: 56%).

This is perhaps due to a combination of COVID-19, criticism from the Kingman review [4], and focus from the FRC.

3 'FCA encourages firms to develop purposeful cultures', FCA, 5 March 2020. www.fca.org.uk/news/news-stories/fca-encourages-firms-develop-purposeful-cultures
4 Independent Review of the Financial Reporting Council, John Kingman, December 2018. www.gov.uk/government/publications/financial-reporting-council-review-2018

ESG considerations

It seems that companies are now paying more attention to reporting environmental, social and governance issues relevant to the business however, limited detail is provided on their impact and/or strategic importance to the business model. Early research indicates that much in this area is rhetoric as there is limited evidence to demonstrate how aspects of ESG are embedded into the wider business' thinking.

As an example, some 31% of companies have an environmental KPI, and 27% consider environmental risks a principal threat to achieving their strategy; 18% say this about climate change risk specifically. Yet just 27 companies (10%) use environmental indicators, and ten (4%) use specific climate change metrics in executive long-term incentive plans and bonuses.

At the same time, 44% of companies have an employee KPI, and 14% of companies have a societal KPI, while only 39 companies (14%) use employee metrics and 14 (5%) use any social metrics in executive long-term incentives and bonuses. Again, the overarching question around accountability arises.

Diversity and succession planning

The new Code emphasises the leadership role that nomination committees should be taking in succession planning. Yet when reporting on succession planning, few companies explain how they aim to identify the knowledge, experience and skills needed in future, so the business can deliver against strategy while responding to challenges beyond the horizon. Overall, boards rarely (4%) refer to how directors' skills are relevant in the context of continuous change.

Seventy-eight percent give little or no insight into board succession, and an even greater number (82%) fail to explain how they identify and develop people for senior management positions.

The new Code sets a maximum board tenure for the chair of nine years. With 25% in our review exceeding that limit, and another 4% fast approaching this milestone, this will add to the increasing workload of many nomination committees. There are only 17 female chairs (2019: 16), so there is an increasing need for companies to rethink criteria and how they access talent.

Gender diversity reporting has continued to improve, with 39% of the FTSE 350 giving good or detailed explanations of their board gender diversity policy (2019: 29%). But there remains a gap between policy and practice, with women filling just 28% of the senior management roles, a key source from which future board succession will hope to draw. In the industrials and oil and gas sectors, this falls to 22% and 21% respectively. With regard to succession, the nomination committee has to look both deeper into the organisation and further ahead if it is to fulfil its responsibilities.

Ninety-one percent of companies are now looking beyond the gender debate to identify different kinds of diversity relevant to their strategy. This year, as last year, the focus has been on ethnic minorities with 66% of companies making reference to such considerations (2019: 42%); the other growing theme is social background (43%; 2019: 34%). Most disclosures simply refer to ethnicity as one of the characteristics considered, without relating it to their business needs or saying whether thinking has been shaped by the Parker review [5].

Stakeholder engagement

It is perhaps no surprise to see a growing focus on wider stakeholder engagement. Two main factors are at play: the refocussed statutory requirement which has forced companies to revisit and re-interpret the emphasis of section 172, with its wider responsibilities for directors beyond the shareholder; and growing societal pressure spurred on by COVID-19, which has driven increased attention to the role business plays with regard to the individual, society and government.

The number of companies which provide good or detailed disclosures on shareholder engagement has risen to 48% (2019: 44%). More committee chairs are taking an active role in engaging with shareholders on their areas of responsibility, with remuneration committee chairs leading the way: 38% met with the shareholders.

Stakeholders remain firmly on the agenda: 77% of companies provide section 172 statements with a varied level of detail and linkage to other disclosures, 38% are detailed. However, only 4% (12 companies) illustrate the long-term impact of board decisions.

Most boards embrace the new requirement for employee engagement, with only ten companies (4%) not mentioning some type of interaction. Seventy-four percent have so far adopted one

5 We note that the FRC commissioned a review of the extent and manner of reporting by FTSE 100 and FTSE 250 companies on ethnic diversity at board and senior management levels, within the 2020 update to the Parker review.

or more of the three suggested approaches for employee engagement, or a combination of these, as specified in the new Code. Of these, 56% have chosen to designate a non-executive director (NED), 28% have adopted a formal workforce advisory panel and 3% have appointed employee directors; 17% use two or three methods.

Remuneration

The new Code requires remuneration committees to address a variety of factors on top of their traditional workload. Many of these changes are intended to better demonstrate the link between executive remuneration and the interests of shareholders and employees, as well as strategic achievements and associated KPIs.

Despite growing pressure from shareholders and other external bodies to address global or social issues as a matter of urgency, companies' choice of performance measures for executive reward remains largely focused on financial metrics. Forty-two percent of the FTSE 350 disclose non-financial metrics in their long-term incentive plans and bonuses; yet, on average, companies report almost an equal number of strategic financial and non-financial KPIs (5 and 4). This perhaps suggests a disconnect between what companies say they value and what they believe drives value.

The requirement to name remuneration consultants reveals further cause for concern. Two of the largest audit firms provide remuneration consulting services to 52% of the FTSE 350. The combination of these firms' domination of the FTSE 350 audit market, the current flurry of auditor re-tendering, the resultant rate of churn, and the length of time that remuneration policies and incentive packages typically cover, suggests that the potential conflict of interest will continue to grow, limiting genuine independent auditor choice even further.

Expanding fair, balanced and understandable

For over a decade this review has tracked the quantity as well as the quality of reporting. In the last ten years alone, the average annual report has grown from 128 pages to 192, with the front end expanding by 73%. On average this translates into an extra 33,000 words in the annual report, or two hours and 45 minutes of extra reading.

With so much more information in the front end of annual reports, it is hard to believe they are achieving the objective of being both transparent and "fair, balanced and understandable". Perhaps now is the time for companies to reconsider the overall approach and determine what information is of strategic importance and what could be placed on their website for a more convenient access by all stakeholders.

This review identifies trends and emerging practices of the FTSE 350 as they have applied the new Code for the first time. In the final section of this report we highlight areas that companies should consider as they prepare for their 2020 and 2021 reporting seasons. If you wish to explore these areas in more detail please contact Alex Worters.

Code compliance and application of principles

59%

comply with the provisions of the 2018 Code

3/5

Three-fifths of those who do not comply with the Code provide detailed explanations as to the reasons for doing so

32%

provide a meaningful statement on the application of Code principles

14%

do not comply with the chair's tenure limit provision

Most companies in our review (74%/207) were required to apply the 2018 Code for the first time; within this population there is a significant drop in those claiming full compliance, to 59%. Of those who do not comply with the 2018 Code, most (56%) report non-compliance against more than one provision. Those (72) applying the 2016 Code report a compliance level at 61%.

One area with high levels of non-compliance is provision 9, regarding the chair's tenure. This provision caused a stir initially. Sixty-five percent of these companies claim to have put succession plans in place, while using the transitional allowance to effect a managed transition – for example, they are waiting for the completion of a significant event such as an acquisition or transaction. Forty-eight companies (23%) applying the new Code have had their chair on the board for more than nine years, but only 31 of these (14%) say they have not complied with provision 19. This explains the disparity between those who report their non-compliance with this provision and the actual number of companies identified.

Also, with relation to the chair's role, other areas where we see relatively high levels of non-compliance include issues such as independence on appointment; combination of the roles of chair and chief executive; and the chief executive becoming chair [6].

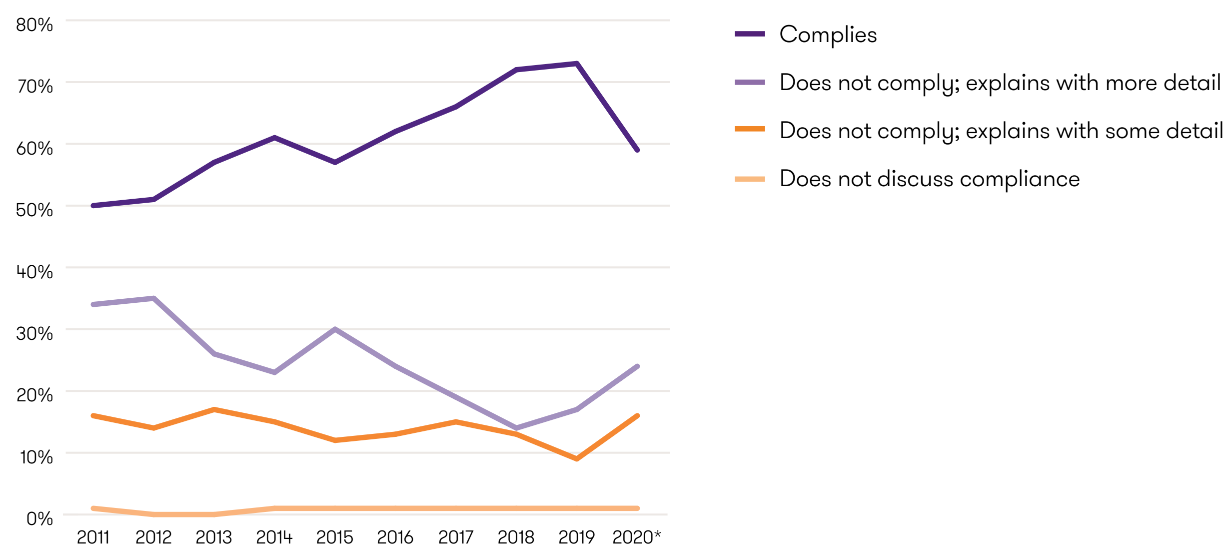
Remuneration-related Code changes are clearly going to require some time for companies to work through if they want to reach full compliance. One example is the need to align executive pensions to those available to the workforce; see the section on the remuneration committee.

Most companies continue to overlook the requirement to include a detailed statement on the application of the principles. While more than half of the companies (56%) provide a statement, less than a third (32%) do this in a meaningful way.

Do companies claim full compliance with the UK Corporate Governance Code? (%)

	2014	2015	2016	2017	2018	2019	2020 (2016 Code)	2020 (2018 Code)
FTSE 350	60.6	57.1	62.0	66.2	72.0	72.9	61.1	59.4
FTSE 100	74.0	64.0	72.0	77.8	74.7	71.0	70.6	60
FTSE 250	54.1	53.8	57.2	60.7	70.7	73.9	58.1	59.1

Do companies claim full compliance with the UK Corporate Governance Code? (%)

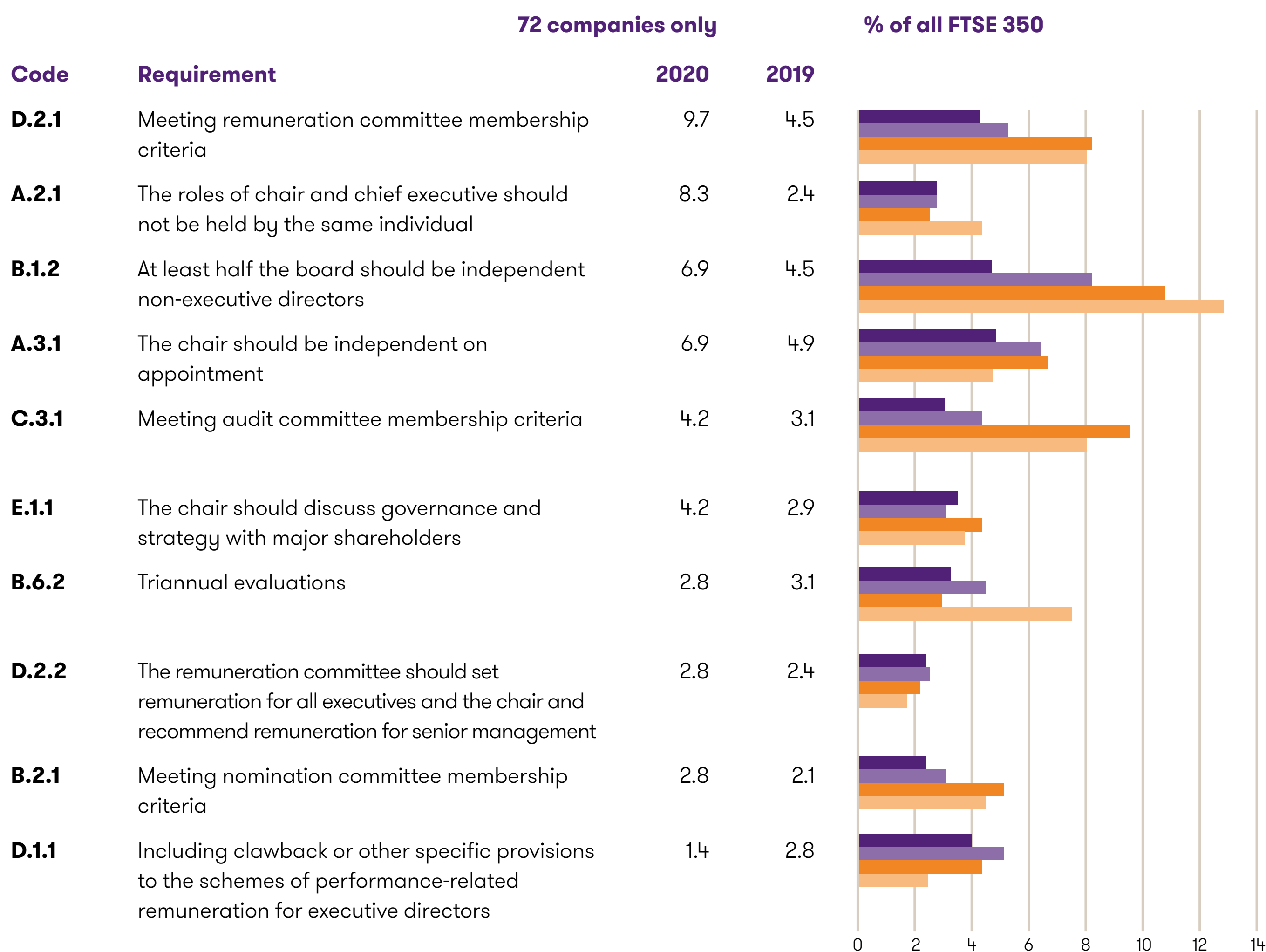


*combined compliance rate with 2016 Code and 2018 Code

6 Provision 9 of the Code says: "The chair should be independent on appointment when assessed against the circumstances set out in Provision 10. The roles of chair and chief executive should not be exercised by the same individual. A chief executive should not become chair of the same company. If, exceptionally, this is proposed by the board, major shareholders should be consulted ahead of appointment. The board should set out its reasons to all shareholders at the time of the appointment and also publish these on the company website."

Areas companies list as non-compliant (%) (2016 Code companies)

● 2018 ● 2017 ● 2016 ● 2015



Code	Requirement	72 companies only 2020	2019
D.2.1	Meeting remuneration committee membership criteria	9.7	4.5
A.2.1	The roles of chair and chief executive should not be held by the same individual	8.3	2.4
B.1.2	At least half the board should be independent non-executive directors	6.9	4.5
A.3.1	The chair should be independent on appointment	6.9	4.9
C.3.1	Meeting audit committee membership criteria	4.2	3.1
E.1.1	The chair should discuss governance and strategy with major shareholders	4.2	2.9
B.6.2	Triannual evaluations	2.8	3.1
D.2.2	The remuneration committee should set remuneration for all executives and the chair and recommend remuneration for senior management	2.8	2.4
B.2.1	Meeting nomination committee membership criteria	2.8	2.1
D.1.1	Including clawback or other specific provisions to the schemes of performance-related remuneration for executive directors	1.4	2.8

Areas companies list as non-compliant (%) (2018 Code)

Code provision	Requirement	2020
19	Chair's tenure limited to nine years	14
38	Alignment of executive pensions to those of workforce	10.6
36	Long-term shareholdings, including 5-year vesting and holding periods or post-employment shareholding	8.7
9	Chair's independence on appointment or separation of roles of chair and chief executive	7.7
32	Meeting remuneration committee membership criteria	5.3
11	At least half the board should be independent non-executive directors	4.8
24	Meeting audit committee membership criteria	4.8
41	Work of the remuneration committee including engagement with workforce to explain alignment of executive remuneration	2.9
5	Stakeholder engagement including workforce engagement	2.9
17	Meeting nomination committee membership criteria	2.4
37	Clawback or other specific provisions in relation to the schemes of performance-related remuneration for executive directors	2.4
12	Senior Independent Director – appointment or leadership of chair's review	2.4
33	The remuneration committee should set remuneration for all executives and the chair; and recommend remuneration for senior management	2.0
21	The board evaluation should be externally facilitated at least every three years	1.9
10	NED independence	1.9
4	Explanation for significant oppose votes ie 20% or more	1.4

Regulator viewpoint

David Styles, Director, Corporate Governance and Stewardship, FRC

The UK Code sets out best practice to achieve high quality governance. Our expectation is that all companies should report on how they apply its principles and provide clear and effective explanations where they depart from its provisions. 'Comply or explain' offers the opportunity for companies to demonstrate good governance by setting out why their approach is right for the company's circumstances and what actions it has taken to mitigate the impact of not following the Code. We welcome such explanations which demonstrate a thoughtful approach to governance.

However, too often companies do not declare non-compliance, offer vague explanations and continue this pattern year on year. This approach demonstrates disregard for effective governance and questions the approach of the leadership within company.

Purpose, value creation and protection

82%

of companies define their purpose, but only 6% actively measure progress

4 out of 9

Four out of nine KPIs disclosed by companies are non-financial

89%

of companies outline what they consider their emerging risks, but only 30% outline how they mitigate these risks

Climate change and the wider economy/ geopolitics are the most cited emerging risks

75

Only 75 companies (27%) identify environmental risks as a key threat

There is much pressure on companies to identify their "purpose beyond profit". In the US, the CEOs' association, Business Roundtable. released a statement in 2019 on the purpose of a corporation, committing its members to serve all of their stakeholders[7]. This focus is also reflected in the 2018 Code, which, as one of its first principles, outlines that boards should establish the company's purpose, values and strategy. Across all sectors, the call to disclose purpose has been welcomed (see chart: Do companies define their purpose?)

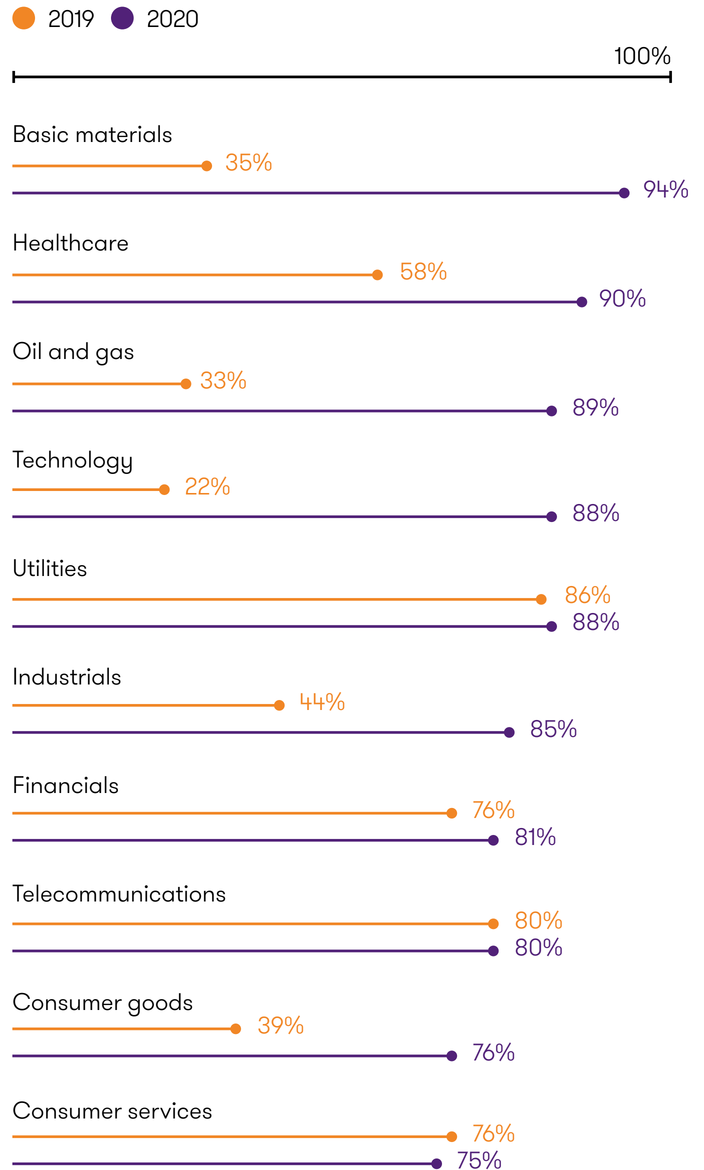
In annual reports, personal statements from leadership add authenticity to purpose disclosures. We find a higher percentage of chairs (60%) than chief executives (41%) meaningfully discussing corporate purpose in primary statements.

Defining purpose not only acts as a guide for stakeholders but provides a framework for how decisions will be taken to create and protect value over the longer term. The Code recommends companies embed purpose by integrating it with strategic priorities – and also with KPIs, risk considerations and executive remuneration.

Having a clearly defined corporate purpose is intended to shape long-term thinking, which in turn helps inform use of capitals and some of the principal and emerging risks to the business and its culture.

The Code stresses the need for a company to shape its values, strategy, and culture in line with purpose. Our review, however, indicates that many statements are more akin to strategic straplines; these show intent but include little detail on how companies embed purpose to provide guidance and decision-making clarity. Just 6% of companies measure progress against their corporate purpose; even fewer link delivery against this purpose to executive remuneration. We find that the two sectors who have best adopted this principle of the Code and sought to embed it, are the financial and consumer goods sectors.

Do companies define their purpose? (%)



7 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves All Americans"', Business Roundtable, August 2019. www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans

Questions to ask

- Is our purpose clearly defined and does it provide decision-making clarity?
- Are we committed to reviewing our purpose at regular intervals to ensure that it continues to drive the right culture, values, and strategic priorities?
- Is there a clear link from purpose to strategy to values to key performance indicators to remuneration?
- Have we developed tangible measures for our purpose?
- What is the impact of our purpose on stakeholders? Consider frameworks such as the UN's Sustainable Development Goals (SDGs)

Purpose, mission and vision – a guide

Purpose is your 'why'
Purpose is the reason you exist, and/or the impact a company intends to have over a sustained period of time. It sits at the core and drives decision-making clarity, inspires those that work with you and helps guide long-term strategy. A constant purpose is a bedrock to build on and the North Star to guide you.

Vision is where you aspire to be
Where you want to get to, in line with your purpose, by a specific point in time; the measurable goals you want to achieve. Your vision is how you want to behave and interact with stakeholders. It is your overall corporate attitude.

Mission is your 'how'
The mission is what actions you want to take to achieve your vision.

Does the annual report explain the board's activities in relation to assessing if the company's policies, practices and behaviours are aligned with the company's purpose and values? (%)

	Yes	No
FTSE 350	66.4	33.6
FTSE 100	72.4	27.6
FTSE 250	63.1	36.9

Best practice disclosure goes beyond stating a duty to fulfil the board's role in determining policies, practices and behaviour. It may also include a discussion of how the company can provide good role models at board and senior management level – disclosing actions such as how the board receives updates from the workforce; how the audit committee reviews whistleblowing reports; or how the remuneration committee takes into account culture when determining pay. Corporate transparency would also include disclosing any action taken to address any areas of misalignment and/or progress of the journey to embedment.

Investor viewpoint

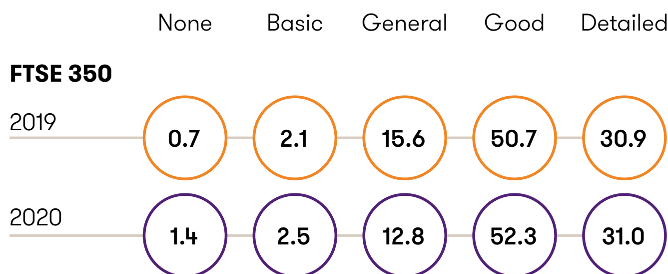
Leon Kamhi, Head of Responsibility, International business of Federated Hermes

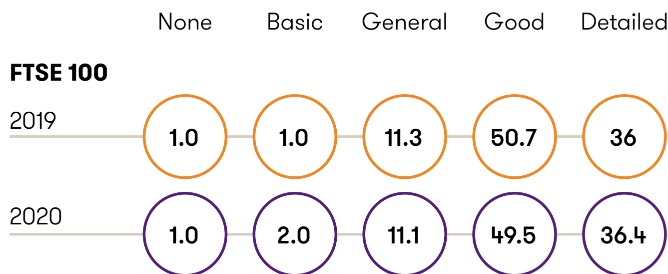
It is a wonder that the clarity of a company's focus is only now getting appropriate attention. It's worrying that companies are not already clear on what they are in business to do, how they ought to serve customers, develop employees and deliver on their social licence to operate.

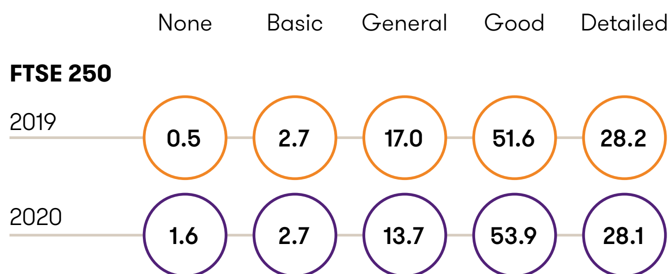
Best practice toolkit - reporting on purpose

Elements/content	Things to consider	Reporting tips
Defining and embedding	Engage with stakeholders and prioritise purpose at board level. Agree a clear and robust articulation of your purpose. A clear purpose gives people something to believe in and operates as an easily identifiable direction in terms of decision-making. Consider how your suggested purpose informs strategic changes and conflicting agendas. Company values should support the achievement of this purpose. Although the purpose is constant, it still may change under some circumstances during the life of business.	Open the annual report with your company's purpose. Clearly differentiate between your purpose, mission and vision (see next page). Articulate your purpose journey – provides transparency showing board engagement in shaping, overseeing and implementing purpose in tandem with other key stakeholders. Showcase alignment with company policies, practices and behaviours. Provide personal commentary on purpose in the statements from the chair and CEO. Provide case studies to showcase how purpose is lived within the company.
Measuring progress against stated purpose	Achievement of purpose cannot be measured directly – it is a more complex process which involves an assessment of impact across a number of capitals material to a broad stakeholder group. To an extent, KPIs which clearly measure progress against the strategy will provide some indication of success. Behaviours that the company encourages should be consistent with the company's purpose.	Consider establishing a framework of financial and non-financial indicators to understand how the purpose is impacting internal and external outcomes/relationships against desired strategic goals as well as environmental and social outcomes. Demonstrate how executive remuneration enables delivery on the stated purpose.

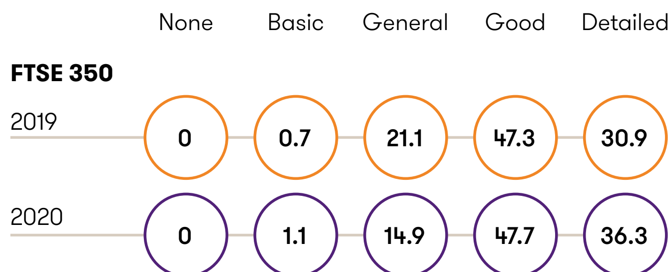
To what extent do companies describe their business model? (%)







Descriptions of principal risks and uncertainties (%)



Strategic reporting

Companies remain broadly strong at articulating their business model, including the resources, relationships and associated elements which help create value. Yet less than a third (31%) clearly show how these aspects inform strategic priorities.

For a number of years, the quality of reporting on past performance has been strong. Disclosure typically covers not only successes, but also the challenges that influence company performance; the external environment, market trends, and identifying and executing strategic opportunities.

The number of companies drawing a link between KPIs and strategic priorities has risen to 71% (2019: 68%). That said, mostly companies do that through signposting or cross-referencing, and only 30% provide real insight into this linkage (2019: 24%). Best disclosures include a clear explanation as to why those performance indicators are the best metrics to use in order to measure delivery against the strategic priorities.

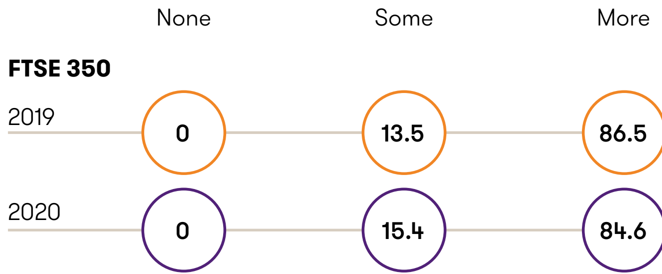
Companies cite an average of nine KPIs, five financial and four non-financial. Some provide too many indicators for them to be considered as strategic metrics, with 10 disclosing more than 20, and one disclosing 30.

Some companies change their KPIs year on year, with little or no explanation as to why; this makes it hard to assess the impact of leadership and/or the direction of travel beyond the short term.

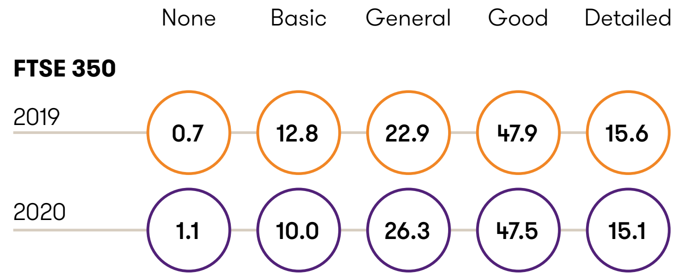
At the same time, it is no surprise that operation risk reporting has expanded, primarily to accommodate the impact of the current environment and the associated reporting of unexpected incidents and pandemic risks.

Perhaps due to current challenges, companies seem more transparent about uncertainties and concerns: they offer more detailed accounts of principal risks, for example by defining them, describing how they mitigate them and providing links to strategy. Disclosures are less generic than in previous years, allowing readers to assess how risks might affect the future business model.

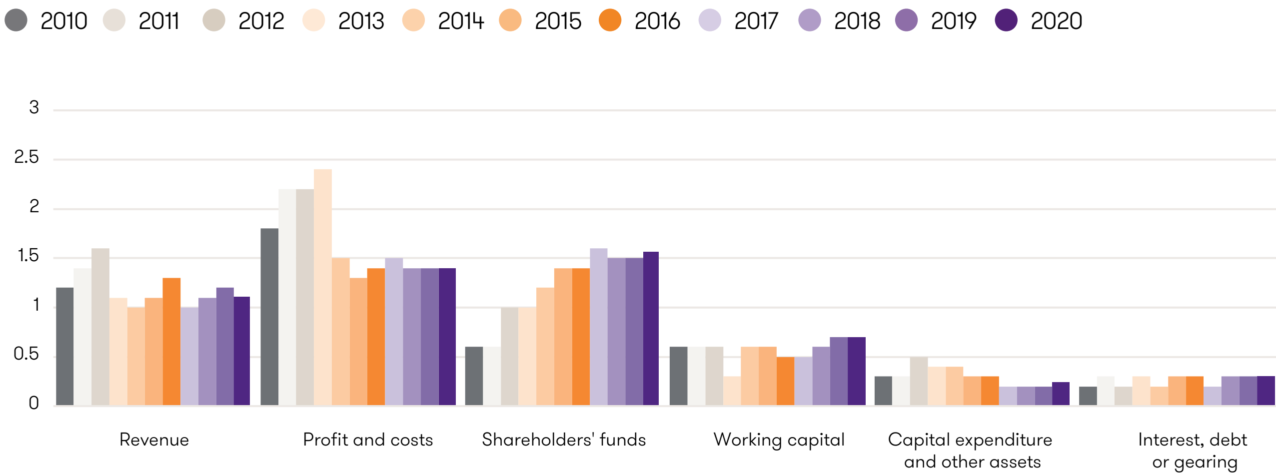
To what extent do companies provide a balanced and comprehensive analysis of their business? (%)



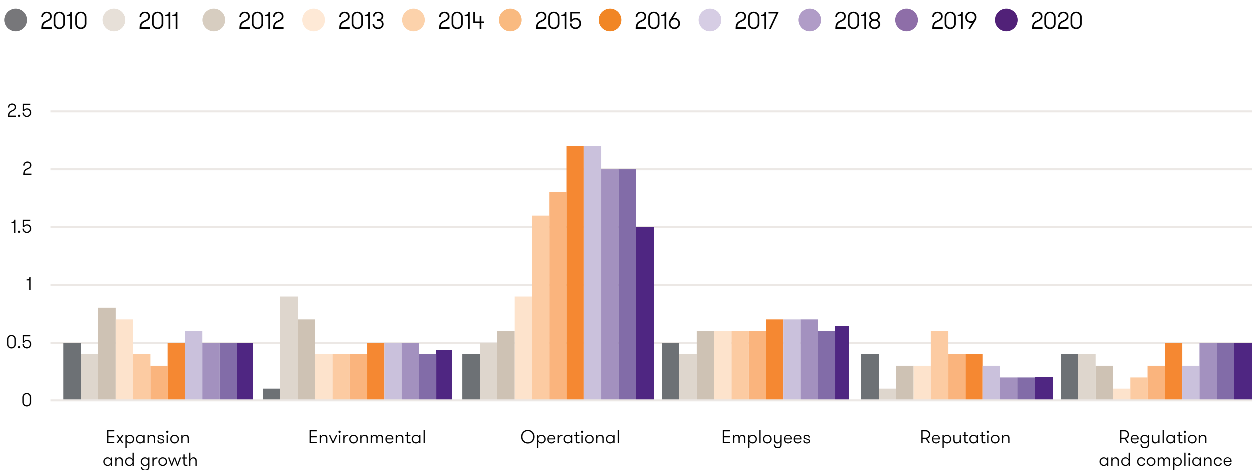
To what extent do companies describe KPIs that measure the performance of the business? (%)



Average number of financial KPIs disclosed



Average number of non-financial KPIs disclosed



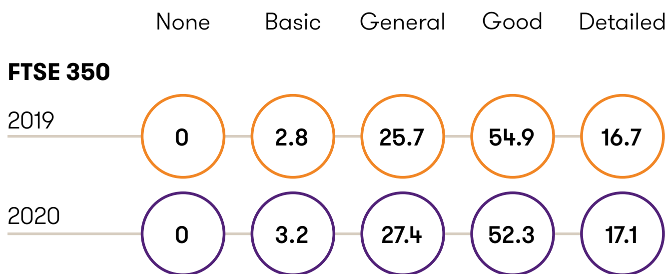
The average number of principal risks reported remains constant at 12, with most disclosing between eight and 14. Of the outliers, four companies report more than 20; these companies might benefit from reconsidering what constitutes a key strategic risk. Some 73% of the FTSE 350 link risks to strategy, but only 18% give explanations as to this linkage in addition to signposting – no change from last year.

The number of companies reporting environmental risks has gone up, although from a low base. Given the growing public and government debate regarding the environment's impact on long-term business, it is surprising that only 75 companies (27%) (2019: 58) identify it as a key threat. See the section on ESG considerations for more on this topic.

Reporting on emerging risks – a new focus of the Code – grew to 89% (2019: 64%); but most companies focus more on the process of identifying risks, rather than identifying the nature of those emerging risks. Only 30% offer insights into their approach to mitigation. Common emerging risk themes include macroeconomics, politics, and climate change.

Figures provided on the next page highlight 10-year trends in the reporting of principal risks. This analysis shows major shifts in the reporting of technology and regulatory risk. Technology changes have been key to corporate transformation in this decade, so it is no surprise to see the rise in the number of risks linked to this area. Regulatory oversight, meanwhile, has grown since the 2008/2009 recession. Areas of risk that have been in decline over the decade, include those associated with financial capital, down from 3.2 in 2010 to 1.7 in 2020; perhaps in response to the rising number of non-financial factors considered.

To what extent do companies describe the likely future development of the business? (%)

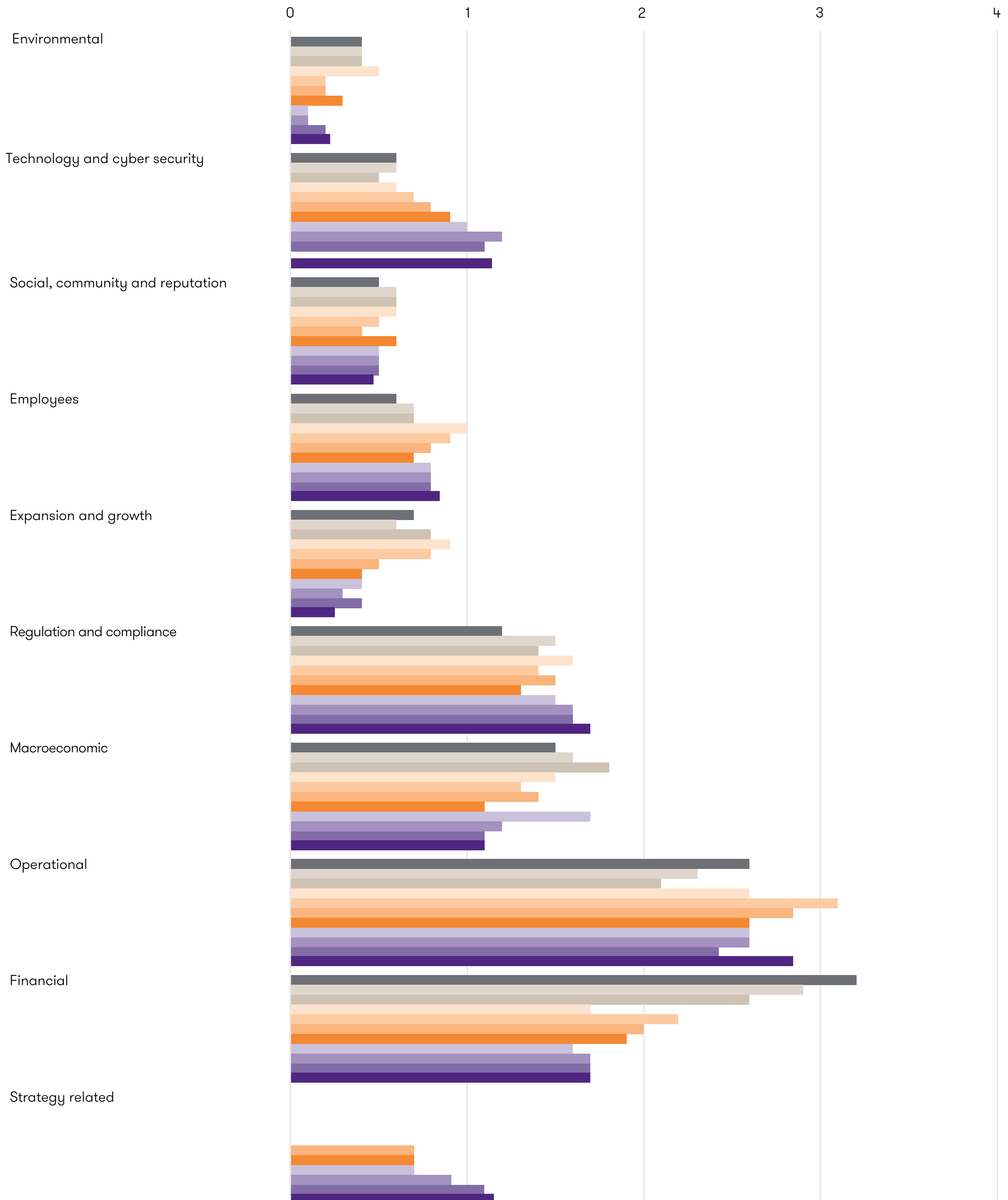


Investor viewpoint

Andrew Ninian, Director, Stewardship and Corporate Governance, The Investment Association

The COVID-19 pandemic has highlighted to all that a company's role in society goes beyond the profits they generate; companies provide the livelihoods, products and outlets that are vital to society. As custodians of long-term capital, investors favour companies that reflect this role and are run for the long term. This means having a clear sense of purpose that drives decisions about its strategy and how the company treats their employees, suppliers, communities, pension savers, customers and other stakeholders. The material impact of the company's wider purpose on society is clear. It is equally clear from investors that this needs to be reflected in material disclosures that go beyond words and demonstrates that purpose in practice.

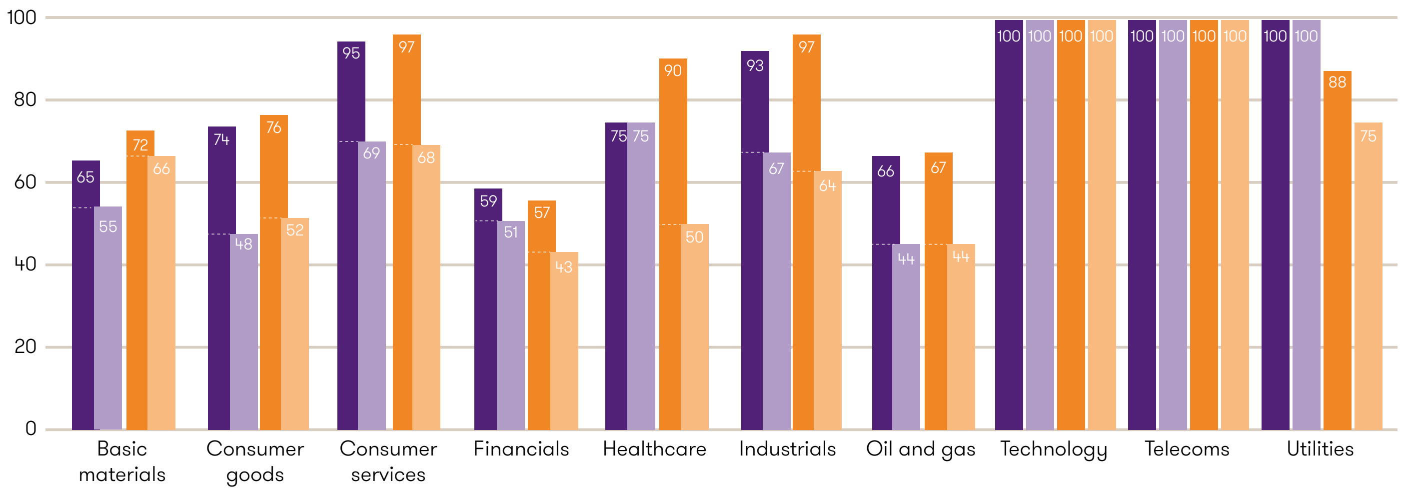
Categories of principal risks



How many companies disclose technology/cyber security as a principal risk? (%)

Technology risk
● 2019 ● 2020

Technology expertise on board (of companies disclosing technology risks)
● 2019 ● 2020



Best practice toolkit - emerging risks

Elements/content	Things to consider	Reporting tips
Description and categorisation	Risk registers should include clearly defined emerging risks, updated regularly in line with any review of strategic priorities Put parameters in place to define when risk is considered as `emerging'	Clearly define and categorise each emerging risk in the annual report Provide sub context behind the categorisation of a risk as emerging – this may include what time frame is referred to. Provide insight on the potential impact of each emerging risk over the short, medium and long-term
Linkage – strategy and opportunities	Consider defining the link between emerging risks and how they are considered in terms of the strategic priorities and overall business model Also, consider opportunities linked to these risks	Explain the linkage between emerging risks and strategy For ESG related areas, consider referencing or aligning to a framework such as TCFD which requires disclosure against risks and opportunities or the UN SDGs
Monitoring and mitigation	Ensure there is a clear process in place to monitor the potential impact of emerging risks on a regular basis Ensure effective processes are in place to manage and mitigate emerging risks Regularly review the relevance of emerging risks to the company's purpose, business model and strategy Remain mindful of sector trends ensuring awareness of the competitive landscape	Describe how the board monitors emerging risks. This may include assigning ownership for a particular risk Disclose any year-on-year trends relating to emerging risks Provide the same level of detail as principal risks about how the company manages and mitigates its emerging risks

Categories of emerging risks disclosed by companies (%)

	FTSE 350
Climate change	24.9
Unexpected incidents/pandemics	20.9
Wider economy/politics	20.3
Operational	12.8
Technology	11.0
Regulation/compliance	10.3
Cyber security/data	6.4
Financial	6.0
Environment	4.6
Strategy	4.6
Employees	2.9
Social/community	2.1

Culture

83%

of companies articulate their values, up from 78%

49%

give good or detailed accounts of company culture, up from 45%

83%

mention how they monitor culture – but often use limited sources of information such as employee surveys or health and safety metrics

51%

do not explain what sources of information they use to assess culture

27

Just 27 companies (10%) say they have developed a dashboard to measure culture

15%

of chairs do not discuss culture and values in their statements; this is significant progress, as 78% of chairs made no reference to it in 2015

It seems that companies recognise the role culture plays in framing and delivering more efficient and sustainable performance outcomes. In the past, reporting focused on areas such as code of conduct training, supply chain monitoring, and other risk management issues – but the narrative now seems to be shifting to the role culture plays as an enabler of business. As identified in our 2019 research, financially successful companies (the top quartile) over a 10 year period typically had better defined culture practices (89%) compared to bottom-quartile performers (33%) [8].

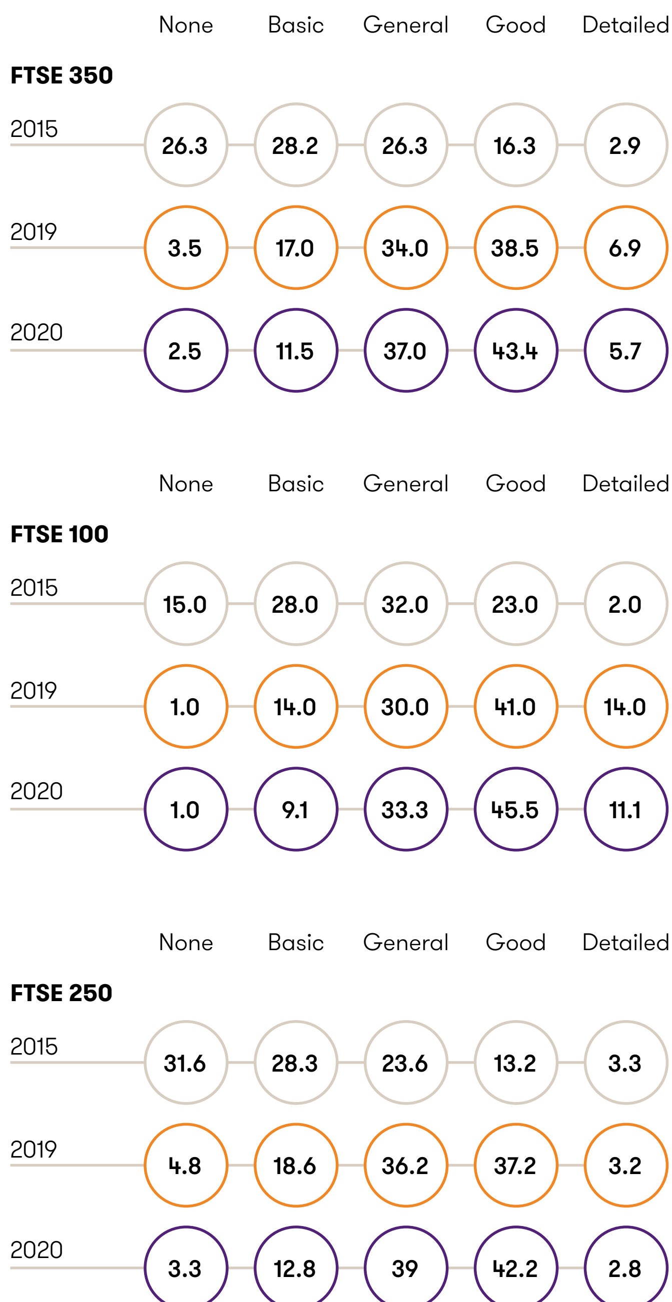
The number of CEOs and chairs who discuss culture within their statements has risen significantly over the past five years, as leaders now more consistently show ownership of this issue. After many years of deferring to chairs on the role of culture, this year the number of CEOs who mention culture is up to 55% (2019: 32%) with the message now being owned by the person most able to influence how culture is embedded in the business.

Sixty-eight percent of companies now acknowledge that culture enables, or is connected to, their strategy; but only 30% provide useful detail about the relationship between the two noting areas such as risks and opportunities. Yet when it comes to linking executive remuneration to culture, numbers are much lower (figure on page 59); it may be that until companies start to compile more sophisticated measures for monitoring culture, this is unlikely to change.

To measure culture effectively, experts recommend that boards compile a bespoke basket of measures[9] which are balanced against key culture drivers, and aligned to specific business goals, so culture impact can be monitored consistently over time. Employee surveys remain the most common method that boards use to monitor culture - this alone is an insufficient measure given it is a point in time assessment, and monitoring culture should involve regular analysis and interpretation of evidence gathered from a range of sources [10].

That said, only 27 companies (10%) have referenced the existence of a dashboard of three or more measures, so there is a way to go before boards can be sure they are consistently measuring the effectiveness of company culture – either in delivering strategic objectives or in meeting wider purpose.

To what extent does the annual report address culture and values? (%)



FTSE 350	None	Basic	General	Good	Detailed
2015	26.3	28.2	26.3	16.3	2.9
2019	3.5	17.0	34.0	38.5	6.9
2020	2.5	11.5	37.0	43.4	5.7

FTSE 100	None	Basic	General	Good	Detailed
2015	15.0	28.0	32.0	23.0	2.0
2019	1.0	14.0	30.0	41.0	14.0
2020	1.0	9.1	33.3	45.5	11.1

FTSE 250	None	Basic	General	Good	Detailed
2015	31.6	28.3	23.6	13.2	3.3
2019	4.8	18.6	36.2	37.2	3.2
2020	3.3	12.8	39	42.2	2.8

8 'Getting smart about governance', Grant Thornton UK, July 2019. www.grantthornton.co.uk/gettingsmartaboutgovernance
9 'A Journey into Auditing Culture: a Story and a Practical Guide', Grant Thornton UK, Susan Jex and Eddie J Best, The Internal Audit Foundation, 2019. See page 68.
10 Guidance on Board Effectiveness, FRC, July 2018 https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF

Regulator viewpoint

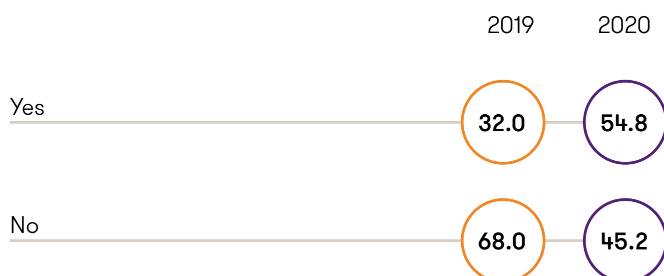
Maureen Beresford, Head of Corporate Governance, FRC

Corporate culture is a very important part of the new Code and we are pleased to see that companies now discuss culture more openly and make efforts to link culture to strategy and long term success. This remains an area that is evolving, with many companies uncertain as to how to best assess and monitor culture. Without a robust approach to continuous assessment culture will not evolve or remain central to achieving long term success. We are concerned about the reliance on the use of surveys and site visits, which cannot give an overall picture. Reports seldom explain actions as a result of any insights gained from the use of these tools, or the effect such information has on strategy, culture or business planning.

Does the chair discuss the culture and values of the company, and where? (%)

	No	Yes, in their primary statement	Yes, in their introduction to the corporate governance report	Yes, in both
2015	77.9	11.9	9.6	0.6
2019	28.1	16.0	30.9	25.0
2020	14.6	14.9	30.6	39.4

Does the CEO discuss the culture and values of the company? (%)



Investor viewpoint

Leon Kamhi, Head of Responsibility, International business of Federated Hermes

The desirability and effectiveness of a firm's culture should be measured by the nature of its leadership and employees' actual behaviours towards customers, colleagues, suppliers and finance providers not platitudes which are so often seen.

Best practice toolkit – culture

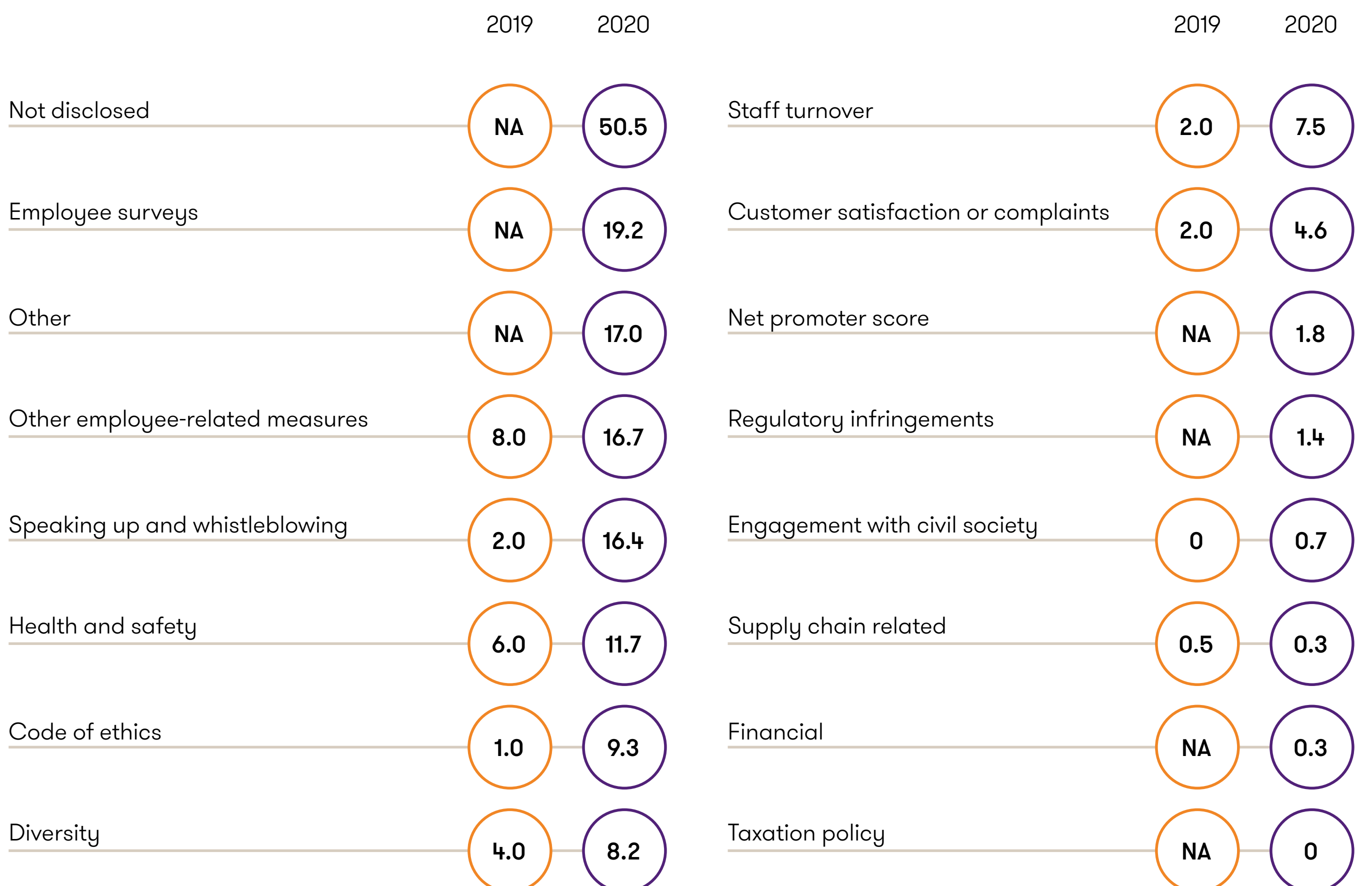
Elements/ content	Things to consider	Reporting tips
Setting the tone from the top	The board and management are responsible for setting the 'tone from the top'. This means understanding and articulating the desired culture framework of the organisation in line with purpose and strategy, and beholding to it in their own working practices and interactions within the company and with its stakeholders. The focus should be on defining what they expect of themselves, senior management and all employees of values, behaviours and the group dynamics. The board should be clear what sort of culture is needed to underpin the company's purpose and deliver its outlined long-term success. The board should consider what behaviours are being driven when setting the strategy and financial targets as well as metrics used in long-term incentives for executives and all employees. Focus on culture should be continuous, not just in times of crisis.	Chairs should discuss the company's culture both in their opening statement to the annual report and their introduction to the governance report. Ensure that there is consistency between the chief executive and chair's views on culture within the annual report, to demonstrate leadership and tone from the top. Between the two, the role, framing, embedding, monitoring and measurement should be clear. Culture should be clearly articulated throughout the annual report and demonstrated via the connectivity of the business model demonstrating how it enables strategic progress. Review the executive remuneration incentives and report what non-financial measures have been introduced to support alignment with culture and strategy in the strategic report.
Embedding	The chief executive is responsible for embedding culture in an organisation. At the same time, senior and middle management are those who have the largest direct impact in daily interactions therefore they should be identified as cultural influencers within the organisation. The board should consider how management communicate what they consider to be acceptable business practices in order to frame corporate behaviour and values. Think how the company is embedding values and capturing behaviours at every level of an organisation: • recruitment process should be aligned with company culture and values, at employee and board level • reward should incentivise desired behaviours • embed strategy and values within HR policies and performance appraisals • training, internal and external communication should be consistent, and deliver the board's message • culture should be consistent with risk management or internal control systems • how middle management is involved in the process • how company deals with breaches of company rules or codes of conduct. Do not forget about other stakeholders, for example, what steps have been taken to ensure that suppliers meet expected standards of behaviour and practice.	Highlight the link between organisation's purpose, strategy, values, KPIs, business model, risks, and reward, and show how these act as embedders of culture. Discuss how company and board culture is integrated in recruitment and reward, within the nomination, audit and remuneration committee reporting. Culture should be referred to in risk management disclosures, and referenced to internal controls. Show how culture and behaviours are shaped via training and other activities, such as culture change programmes within the strategic and nomination committee reports. Consider including case studies providing transparency around expected good practice and excellence that can be used to role model standards across the business, reinforcing the role that a healthy culture has in unlocking strategy. Be honest about the organisation's culture journey, highlighting not just the opportunities but also how challenges/misalignment are identified addressed or mitigated.

Best practice toolkit – culture

Elements/ content	Things to consider	Reporting tips
Monitoring and measuring	The board should assess culture and challenge the executives on its support of both the strategic objectives and purpose over the short and longer terms. Boards should give careful thought to how culture is monitored and assessed and what sources of information are used. Devote sufficient time and resources to evaluating culture to assure that the report provides clarity that: • senior management are clear and supportive of the culture • values are well defined and understood at all levels • actions and behaviours at different levels of the firm are in line with culture. Commenting on culture should consider quantitative and qualitative information gathered from different sources, rather than reliance on one method or measure and tracked over time. Understand how technology can be used to collect, analyse, interpret, and present information.	Explain how the board seeks to assure itself that behaviours at different levels are in line with the culture. Show how culture is considered when assessing the effectiveness of risk management and internal control systems. Disclose some practical illustrations and numerical metrics (see table below) or how the company gauges effectiveness of the culture programmes that are used to shape outcomes. It is important to show how those indicators are relevant for the company and what it wants to achieve.

What methods does the board use to monitor culture? (%)

What sources of information do companies use to assess culture? (%)



Stakeholder engagement

38%
provide detailed section 172 statements

12
Only 12 companies (4%) illustrate the long-term impact of board decisions in the context of stakeholder considerations

26%
do not adopt any of the three employee engagement approaches recommended in the new Code

48%
Shareholder engagement increased for the second time, after years of decline: 48% (2019: 44%) provide good or detailed disclosures

1/3
Over one-third mention shareholder engagement by the senior independent director, 38% by the remuneration chair

10%
Just 10% specify actions taken as a result of the information collected from shareholders

The impact of COVID-19 has provided situational evidence as to the importance of strategic stakeholder management. Successful boards are seemingly more forensic in considering how they balance the demands of differing stakeholder groups, as they look to achieve more positive and sustainable longer-term outcomes.

Stakeholder discussions are increasingly prominent in most reports: all but six companies identify their key stakeholders, often in dedicated sections in the strategic report, but also in the corporate governance report.

There remains, however, work to do to demonstrate how each stakeholder group influences the development and delivery of strategic priorities, and equally how stakeholder needs impact on company decision-making. Most companies articulate who stakeholders are and how they engage with them; but only 23% link stakeholder considerations to strategy and KPIs, while 30% explain how two-way dialogue with stakeholders is organised.

Seventy-seven percent of companies provide section 172 statements with a varied level of detail and linkage to other disclosures; 38% provide detailed statements. At the same time, 46% now provide much better disclosures on how stakeholders' interests and other matters set out in section 172 influence board decision-making. That said, only 4% (12 companies) illustrate the long-term impact of these decisions.

Most companies embrace the new requirement on workforce engagement; only ten (2019: 38) mention no type of employee engagement. FTSE 100 members, though, are less active in adopting new ways of engagement, compared to their FTSE 250 peers; they often state that due to their size, complexity and geographical spread, they will carry on using established channels such as surveys or town halls.

Overall, 74% of companies have adopted one or more of the three approaches specified in the new Code, while 17% use two methods (mostly a combination of a panel and the NED); the rest have either repurposed employee surveys/ questionnaires or refer to less structured means of engaging with employees.

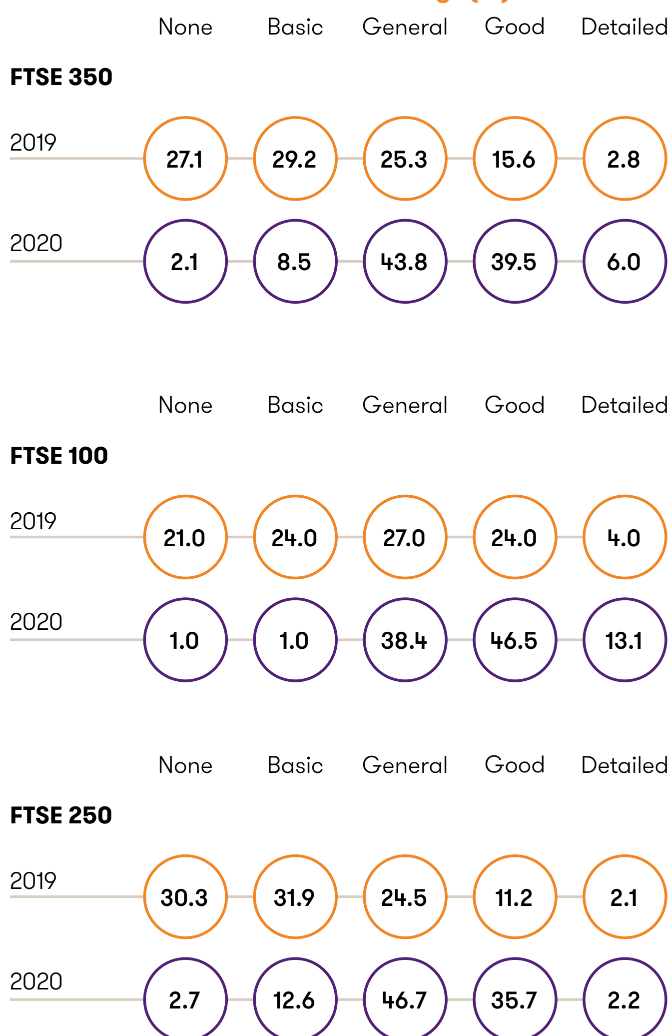
This represents a challenge because the idea is to encourage real-time, two-way dialogue, to inform decision-making. Surveys tend to be an assessment at a single point in time and are less interactive than the process outlined by the Code. Whether new methods of active engagement are already evolving as a result of the COVID-19 crisis will not be clear until next year.

For two years, the way companies engage with investors has been improving; this comes after years of a declining trend. More committee chairs are taking an active role, possibly due to a focus on this type of engagement in the new Code; perhaps reflecting the increasing pressure on specific governance areas, such as remuneration and climate risk which are particularly high-profile. The 2020 UK Stewardship Code[11] – with its focus on activities and outcomes, as well as material ESG factors – has driven greater scrutiny of investors' role in engaging with companies which in turn is also driving this now increasing trend in shareholder engagement.

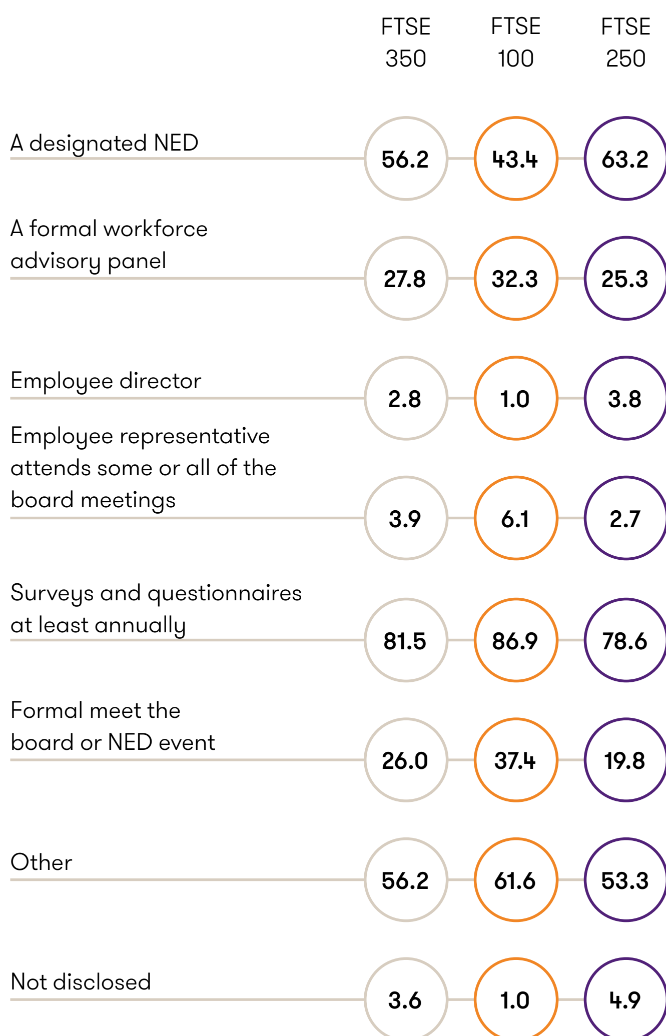
Yet only 10% of companies clearly explain actions they have taken as a result of information and dialogue with shareholders; more progress is required.

11 The UK Stewardship Code', FRC, 2020. www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

Does the board explain in the annual report how their stakeholders' interests and the matters set out in section 172 influenced decision making? (%)



How does the board gather the views of the workforce? (%)



Regulator viewpoint

Maureen Beresford, Head of Corporate Governance, FRC

As the regulator, we would like company reports to explain how engagement with stakeholders has affected long-term decision-making. Our assessment demonstrates too much reliance on reporting the process of engagement, but often there is little clarity on how issues raised are presented to the board for consideration and the impact on decision-making. We recommend that companies focus on improving engagement and reporting next year, particularly in the light of the response to the pandemic.

Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

Our stakeholder disclosures in relation to section 172 were also a key area of focus. Here we sought to build on the detail provided the previous year which had recorded more of the 'what' we did in relation to the various stakeholder groups. This year we sought to give more insight into the 'why' and 'how' the board had considered the impact of its decisions on our stakeholders, an area which we will look to develop further next year.

In relation to our employee stakeholders, while the UK Code provides three methods for engaging with employees, we are continuing to explore the engagement arrangements that are most effective for the Group. The structure, size and extensive geographic footprint of Standard Chartered is such that, for now, effective engagement with all our c. 90,000 workforce across 59 markets is unlikely to be achieved using the methods suggested by the UK Code. The Governance and Nomination and the Brand, Values and Conduct Committees explored a variety of ways of engaging with our colleagues and during the year we held a number of local townhall, face to face meetings, interactive global teleconference and online Q&A sessions with board members. We provided insight into the effectiveness of these different sessions in the annual report. This year will build on these insights, using various technologies to reach all our geographies and ensure as personal and visible an engagement as possible for all colleagues with all our board members.

Investor viewpoint

Andrew Ninian, Director, Stewardship and Corporate Governance, The Investment Association

Investors have welcomed the renewed emphasis on the implementation of director's duties and wider stakeholder engagement. Considered engagement with key stakeholders informing board decision-making will strengthen businesses and promote long-term value to the benefit of shareholders and stakeholders alike. The current reporting on stakeholder engagement could be improved by boards outlining how the stakeholder views heard have impacted on board decision making. 2020 could be a major fork in the road for the future of Section 172 reporting. COVID-19 presents a consistent case study across businesses that will allow investors to compare and contrast the actions taken by companies to supporting and engaging their stakeholders through the pandemic. Successful reporting will provide investors the insights they need to help support those companies.

To what degree does the board demonstrate the steps taken to understand the views of major shareholders? (%)

FTSE 350	None	Some	More
2016	2.3	61.7	36.0
2017	0.3	67.2	32.5
2018	0.7	68.0	31.3
2019	0.7	55.5	43.8
2020	1.1	50.8	48.0

FTSE 100	None	Some	More
2016	1.0	47.0	52.0
2017	1.0	44.4	54.5
2018	1.0	54.5	44.4
2019	0	37.0	62.0
2020	1.0	27.3	71.7

FTSE 250	None	Some	More
2016	2.8	68.8	28.4
2017	0	78.2	21.8
2018	0.5	74.7	24.7
2019	0.5	65.4	34.1
2020	1.1	63.7	35.2

Does the chair meet with shareholders, and do they discuss governance and performance against the strategy? (%)

Who attends meetings with major shareholders? (%)

	Met with shareholders		Available to meet with shareholders	
	2019	2020	2019	2020
Senior Independent Director	25.7	34.5	44.4	39.8
Remuneration committee chair	22.2	38.4	24.0	22.7
Nomination committee chair	8.7	8.8	15.6	12.4
Audit committee chair	4.2	11.3	9.4	13.1
Other	5.6	6.7	16.0	8.8

Best practice toolkit - shareholder engagement

Elements/content	Things to consider	Reporting tips
Calendar	Summarise the shareholder engagement programme for the past year as well as the main planned events of the forward-looking calendar.	Where possible, include the financial reporting calendar and any upcoming events.
Methods	Take time to reassess how the company engages with shareholders: • how is information communicated? • how is participation encouraged? • how often?	Provide details on day-to-day processes and interactions that take place outside the planned programme of events. Identify all forms of engagement throughout the year –the annual report, other reports, formal presentations, AGM, conferences, surveys of shareholders' opinion, meetings with brokers and analysts.
People engaged	Consider who is engaged in the dialogue, and who should be engaged. The Code requires the chair to seek engagement with major shareholders in order to understand their views on governance and performance against the strategy. Consider regularity of dialogue. Ensure committee chairs engage on important issues related to their areas of responsibility.	State the timing and rationale for chair-attended meetings, and include information on how the chief executive, company secretary, senior independent director, chairs of committees or other directors engaged with shareholders.
Key features/topics of engagement	Assess feedback from shareholders regarding specific issues, including how this is garnered and achieved. Consider the company's compliance with the Code and if any deviations from the Code were discussed with shareholders.	Report on key issues that investors raised and were invited to engage on Disclose how many meetings took place, what directors were engaged and what issues were discussed. Reference how previous matters were resolved.
Outcomes	Reassess the board's understanding of shareholder concerns and if those issues are being allocated sufficient time in board meetings. It is the chair's responsibility to ensure that the board as a whole has a clear understanding of major shareholder views.	Provide details on the feedback and any outcomes arising. Explain if any actions/decisions were taken as a result of board/management consideration and how the shareholders were made aware of the outcomes.
Other considerations	Does the explanation of shareholder engagement add to the reader's understanding? Is there more you do that would add to this understanding? When appropriate consider changes in the investor profile – geographic split, investment rationale and whether there are unintended consequences for the company.	Include a final summary on actions taken in relation to any significant votes (20% or more) against a board recommendation for a resolution at a general meeting.

ESG considerations

77%

of companies give a good or detailed level of explanation on environmental matters

27%

Just 27% identify environmental risks as a principal threat. 31% have an environmental KPI

10%

Only 10% use climate change or other environmental metrics in executive long-term incentive plans

14%

of companies have a social KPI

5%

Only 5% companies remunerate executives against social metrics

The role of business in society is increasingly coming under scrutiny. As they consider their 'licence to operate', companies need to address a wide range of issues as it becomes more apparent that access to capitals other than finance is becoming increasingly constrained. These issues include climate change; access to resources; social inequality, the role of technology and automation, including its ethics, opportunities, and impacts; demographic change; social mobility; and most recently COVID-19.

Environmental stewardship, of course, has been in the spotlight for some time. Due to COVID-19, investors and other stakeholders are focusing on corporate social responsibility – which pits perceived short-terms costs of fulfilling stakeholder responsibility against the need to preserve cash and profits to survive.

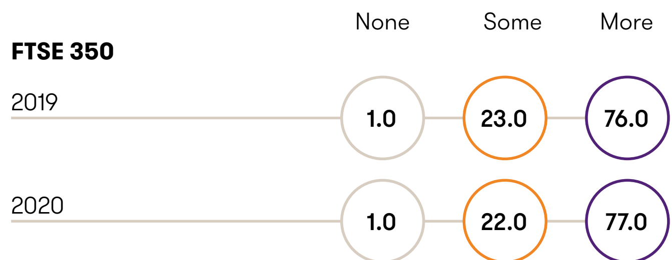
Most companies provide increasingly detailed disclosures on environmental considerations such as climate change. Yet despite often copious disclosures, less than a third make the link to strategy. Only 31% of companies have an environmental KPI, while only 27% consider environmental risks a principal threat to their strategy (the figure for climate change is 18%).

Further, with regard to the environment, it is unclear how companies are integrating appropriate action and decision-making at the top: just 27 (10%) use environmental indicators in executive short and long-term incentive plans, of which ten (4%) use specific climate change metrics and bonuses.

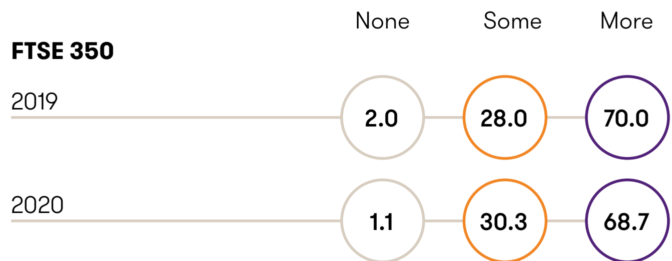
The composition of FTSE 350 workforces average 39% women and 61% men; this is unchanged from 2019. That said, seven in ten industries improved their gender diversity at senior management level [12]. When companies disclose this, they mainly combine it with an explanation of the culture and values of the organisation.

But despite this forward-step, only 44% of companies have an employee KPI and just 14% have a social KPI. When it comes to executive remuneration, just 39 companies (14%) use any that are employee-related, while only 14 (5%) use social metrics.

To what extent does the company explain environmental matters? (%)



To what extent does the company explain social, community and human rights activities? (%)

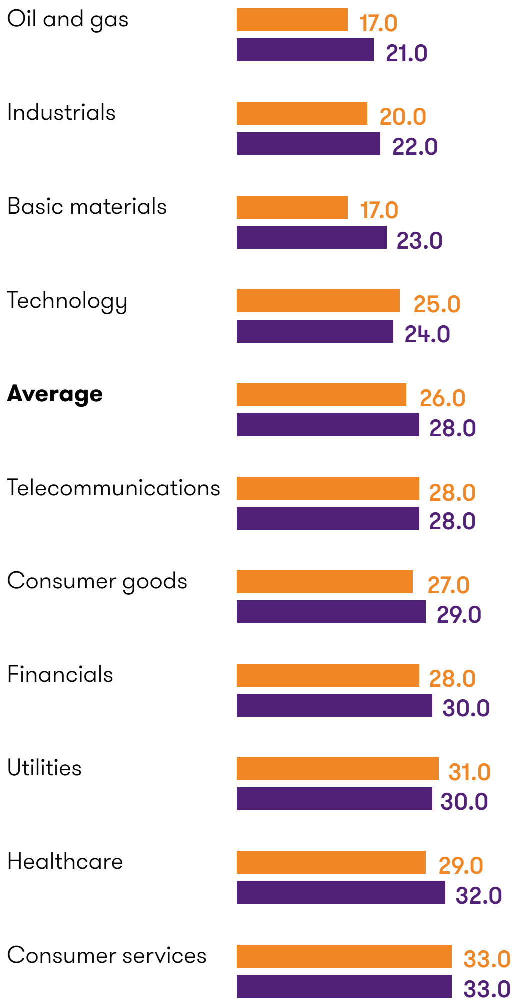


DID YOU KNOW?

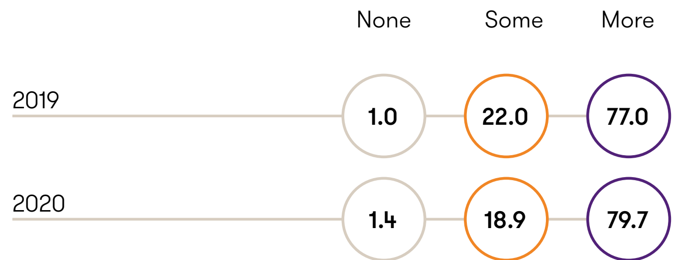
An increasing number of companies are quantifying their positive impact, reflected in an impressive uptake in new commitments to initiatives such as the UN Sustainable Development Goals (SDGs). Eighteen percent align their reporting to the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, while further 25% mention TCFD.

12 'Senior management level' is the first layer of management below the board level, according to the 2018 Code.

Senior management gender split by industry (% women)



To what extent does the company explain employee matters? (%)



Investor viewpoint

Andrew Ninian, Director, Stewardship and Corporate Governance, The Investment Association

It is increasingly acknowledged that material environmental, social and governance (ESG) risks can have an impact on long-term shareholder value. Therefore, incorporating the management of material ESG risks and opportunities into the company's strategy is crucial. Non-financial information is increasingly a key consideration for investors. Investors expect companies to be considering how to adapt or strengthen their business model and strategy to either mitigate ESG risks or to make the most of the opportunities that arise. This may extend to setting quantifiable ESG targets to deliver on the company's strategy, that can feed through to remuneration so that executives are incentivised to create the long-term value that investors seek.

Board composition, responsibilities and effectiveness

51%

provide good or detailed explanations of board evaluation, with 46% providing detail on outcomes

63%

give little or no information on the skills and experience of their board

4%

refer to how directors' skills are relevant in the context of strategic risks, regulatory change and market shifts

70

companies have had their chair on the board for more than nine years

12

companies have an executive chair, and two companies have the CEO and chair roles held by one person

17

FTSE chairs (6%) are currently held by women

The composition of boards continues to evolve, with 227 companies appointing at least one new director this year. Given the Code's focus on succession and the availability of appropriate skills, the quality of disclosures in relation to the skills and experience of directors remains weak; 63% give little or no information on these factors and how they can support strategy. Only 4% refer to how directors' skills are relevant in the context of strategic risks, regulatory change and market shifts.

A rising number (66%) say they have a director with a technology background, strengthening their ability to address technology opportunities and risk (2019: 62%). Despite the growing number of such appointments onto the board in the majority of sectors, financials and healthcare have slipped and oil and gas continues to struggle to recruit. This may leave them vulnerable to the increasing risks in this area.

Twenty-three percent of companies, as last year, have at least one NED deemed to be not independent.

Thirteen percent have appointed a new chair this year (35 companies, 2019: 56 companies). Seventy companies have had their chair on the board for more than nine years, with another 10 fast approaching this milestone.

The tenure of chairs adds to the workload for nomination committees, who are also under greater pressure to address systemic diversity issues; just 17 FTSE chair positions are held by women (2019: 16).

Breaking down the issue of tenure further, seven companies mention the need for the chair to remain in place for orderly succession planning, including development of a diverse board, which is allowed by provision 19 for a limited time period. Another 14 companies refer to the chair's knowledge and experience, and what is considered to be in the best interests of the company and stakeholders; six more refer to the need for the chair to remain to ensure stability and continuity in the course of a corporate event such as an integration or acquisition. Ten disclose a forthcoming replacement; these, positively, show a 50–50 gender split, the remaining 33 give no explanation at all.

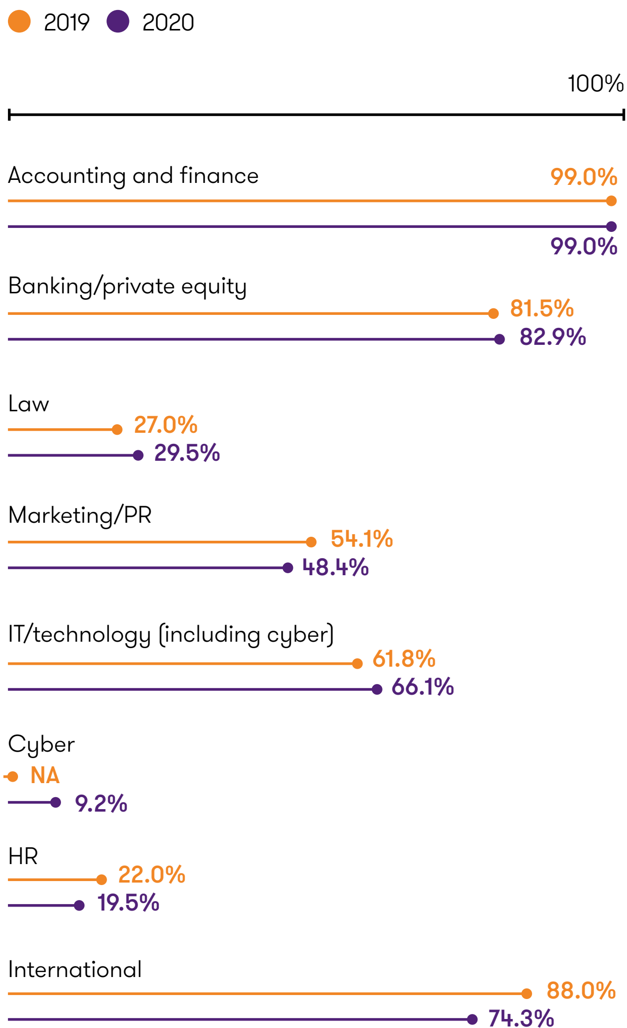
Twelve FTSE 350 companies (4%) have an executive chair, and two companies have chosen not to comply with the Code's requirement on not having the CEO and chair roles held by one person – a decreasing occurrence although still relatively a significant area of non-compliance with the Code [13].

When it comes to the review of board effectiveness, companies are improving their transparency about process, but still seem reluctant to give details on outcomes, as these are often considered "too sensitive" for the annual report. When they do disclose areas for development and follow-up, companies tend to indicate broad areas of focus, but provide limited detail. Across all companies, there are some common development themes, with increasing time required on strategic priorities and value generative dialogue being the most common.

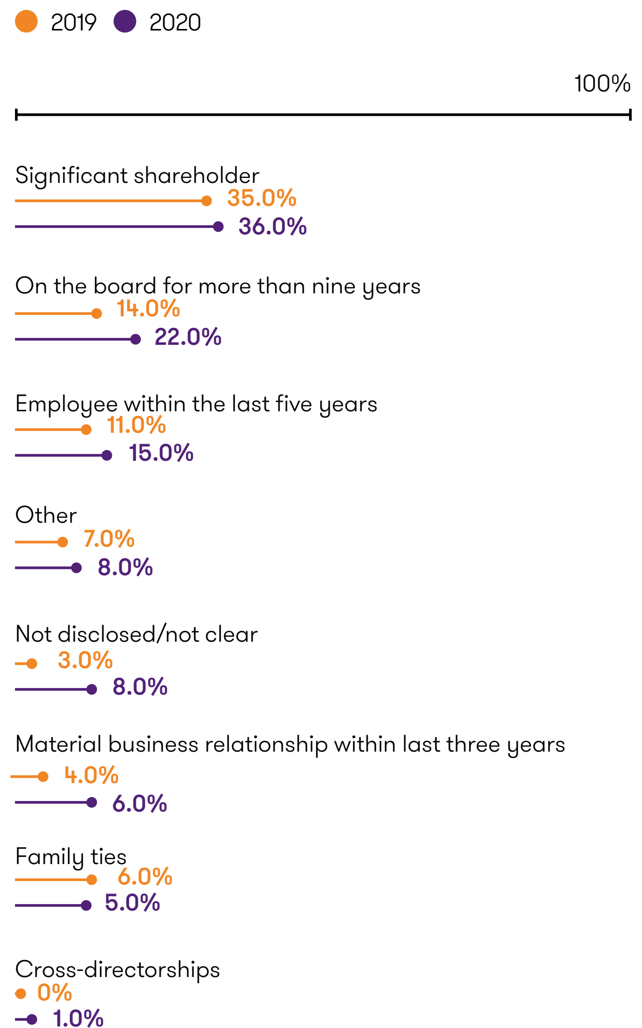
Thirty-two board evaluation organisations are active across the FTSE 350 (2019: 34). These include dedicated board evaluators, one-person firms, larger organisations, academics and search companies. The top two organisations are responsible for 40% (2019: 38%) of all external evaluations conducted during the year. One organisation completed 27% (2019: 24%) of all reviews, alongside a 'long tail' of firms conducting just one or two. What was surprising that we could discern no new or innovative methods being introduced to evaluate boards perhaps suggesting that the process has become stymied in the provision of assurance rather than being used to develop and change board practices.

13 In our 2012 Corporate Governance Review, 10 UK companies had a joint chair and chief executive, with another seven combining the roles at some point during the year.

How many companies disclose having board members with experience in the following areas? (%)



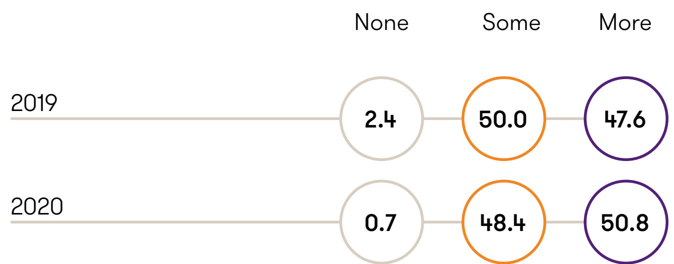
Why are non-executive directors not considered independent? (number of companies)



DID YOU KNOW?

We record information from more than 220 data points per company. You can learn how your board composition, KPIs, risks and other communicated governance practices benchmark against your peers by using our governance dashboard separately or as a part of your board effectiveness review

How much explanation is there of how the board, committees and individual directors are annually formally evaluated for their performance? (%)



To what extent are the outputs and actions arising from the board evaluation disclosed? (%)

What development areas have been identified from the evaluation conducted during the year? (%)

Best practice toolkit - board effectiveness review

Elements/ content	Things to consider	Reporting tips
Methods	Use board evaluation as an opportunity to identify areas of excellence and improvement in line with business strategic goals. It should be tailored to the board in the current year. Whether conducting an internal or external review, it should cover (but not be limited to): • relevance of the mix of skills, experience, knowledge and diversity on the board, in the context of the challenges facing the company • the working relationship and dynamics between key board members, particularly chair/CEO, chair/senior independent director, chair/company secretary and executive/non-executive • effectiveness of individual directors • effectiveness of board committees, and how they are connected with the main board • effectiveness evaluation of the chair by the non-executive directors led by the SID • timeliness and quality of the general information provided on the company its performance • decision-making structure, processes and authorities. The chair should consider ways in which to obtain feedback from the workforce and other stakeholders. Chairs of board committees should be responsible for the evaluation of their committees.	The description of evaluation should explain the mechanism and/or approach used for board evaluation (eg surveys, face-to-face interviews, meeting observation, documents review, psychodynamic tests, external facilitation) and the criteria for assessment. Explain why the chosen approach or method was considered best in measuring the effectiveness of the board at this time.
Outcomes	Produce a clear plan for addressing areas of improvement, including actions planned, timescales, and connection to board training and development, succession planning and future appointments, where appropriate. Discuss the outcomes at the board meeting and demonstrate a feedback loop. The chair should take the responsibility for the process and follow up on the actions for the board as well as individual directors.	Outline the key findings and outcomes, not just a general statement that the board operates effectively. Show that sufficient value is placed on the evaluation process and be specific about the outcomes, areas of excellence and areas for development. Identify planned actions and their timeline (eg 1-3 months, 3-6 months, 6-12 months). Best practice reporting also makes reference to previous years evaluations and demonstrates how the board have met previous year actions and if that led to the desirable outcome

Best practice toolkit - board effectiveness review

Elements/ content	Things to consider	Reporting tips
External evaluation	Board evaluations should be externally facilitated triennially, in line with the Code. Ensure that an external facilitator provides you with a clear set of recommendations and actions, and a time-period for review of progress at the end of the review. Ideally it should also include views from beyond the boardroom, e.g. senior executives who regularly interact with the board and perhaps for the audit committee, the external auditor. Agree with an external evaluator what process is to be followed and what information on evaluation outcomes should be disclosed. Consider having a facilitated session or a follow-up with the external evaluator to discuss accountability for action and the progress on agreed outcomes. Consider using a different evaluator to previously, to get a different viewpoint.	Provide the name and details of the independent organisation if board evaluation was externally facilitated, and an explanation as to why this organisation was chosen. If you do not conduct a triennial board evaluation, state your non-compliance and provide the reason why: the timing may be unsuitable for the board, for example.

Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

When we look at reporting the board's activities during the year, we aim to give our stakeholders insight into how our board provides oversight, its considerations and its governance processes. Our disclosures reflect the culture of the Group and providing these insights helps strengthen our governance practices.

It is encouraging therefore that several areas of focus within our governance framework over the last few years have become recognised as particular areas of strength, especially in relation to our risk management, internal control processes, remuneration disclosures, consideration of our stakeholders, stakeholder engagement (including employee engagement) and actions to enhance the long-term effectiveness of our board.

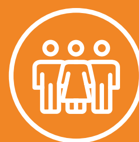
Nomination committee

0%

No company provides detailed disclosure on succession planning for senior management

66%

disclose ethnic diversity this year in their policies, up from 42% last year



39%

provide good or detailed disclosure of gender diversity, up from 29% last year

3

pages remains the average of nomination committee reports, despite the expanded remit of the committee

This year has seen a broadening remit of the nomination committee's important role in ensuring that leadership within the organisation does not only have the credibility and capacity to deliver results today but is fit for the future. This ensures that skills are appropriately and continuously reassessed to meet the evolving strategic needs of the organisation, while embracing the underlying imperative to create, retain and protect value for the benefit of both its shareholders and wider stakeholders.

The review of this year's annual reports indicates that this committee has yet to fully embrace these new responsibilities. In particular it has to consider how it provides further transparency and challenge to the succession planning process to ensure that it evolves from being largely transactional – it oversees the new board appointee - to one that helps shape the business.

The nomination committee's remit was extended under the 2018 Code, with a particular focus on two areas: succession planning beyond the board; and diversity. Despite these increased responsibilities, the average number of pages in reports remains at about three (see the section on annual report and quality of reporting).

Under the new Code, the committee must take accountability for the organisation's approach to succession planning, including overseeing the building of a diverse pipeline beyond the board. Given that we found no detailed disclosures on this subject, clearly approaches are still being considered. One anecdotal comment suggested that many companies have yet to find the balance between oversight and operational accountability.

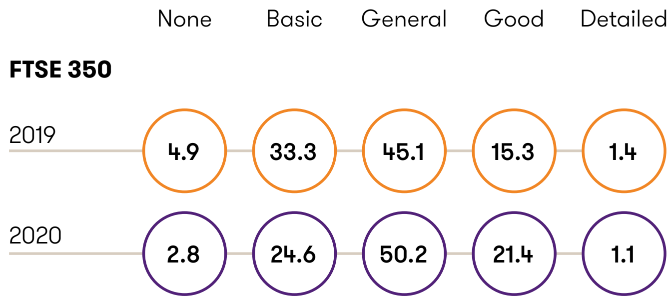
Provision 23 requires nomination committee disclosures to include the company's policy on diversity and inclusion – covering objectives and links to strategy; implementation; and progress made. But less than a third discuss progress against this policy, while most simply refer to the company's diversity policy (38%); 32% do neither. The Code puts the onus on the committee to actively demonstrate its ownership of this issue, so we would expect to see disclosures evolve in this area.

Ethnicity is a rapidly developing theme in diversity reporting: 66% mention it as part of the list of characteristics considered for board diversity. The Parker review's most recent update says that 37% of FTSE 100 boards have no ethnic minority representation, while for FTSE 250 boards this rises to 67%. This will clearly require more focus, intervention and detailed disclosure from the nomination committee going forward. In addition, social background and, to a lesser degree, age, are attracting more consideration as companies seek to broaden their pool of knowledge and experience.

Questions to ask

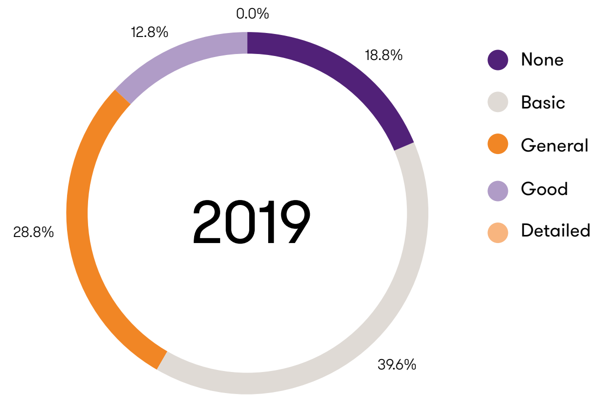
- How frequently is diversity discussed at board meetings – especially given the link to a company's culture?
- How is diversity of discussion encouraged and embedded?
- Does the board actively encourage sponsorship of minorities within the business?
- How forward-looking is your succession plan? Does it cover short, medium and long-term succession planning? Is it linked to, and regularly reviewed alongside, the strategic priorities of the company or is it driven by tenture?
- What is the action plan for identified diversity gaps? Is this owned and monitored by the nomination committee – and by extension the board as a whole?
- How conversant is the board with recent events with regards to diversity? Are the board and the nomination committee familiar with BAME and LGBTQ+ issues, as well as other aspects of diversity such as cognitive traits?
- Does the composition of the board and senior management reflect the company's diversity of customers and other stakeholder groups?

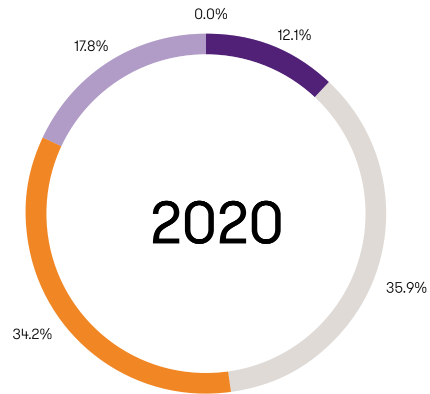
To what extent do companies describe board succession planning? (%)



FTSE 350	None	Basic	General	Good	Detailed
2019	4.9	33.3	45.1	15.3	1.4
2020	2.8	24.6	50.2	21.4	1.1

To what extent does the board describe the company's succession planning for senior management and development of a diverse pipeline (%)

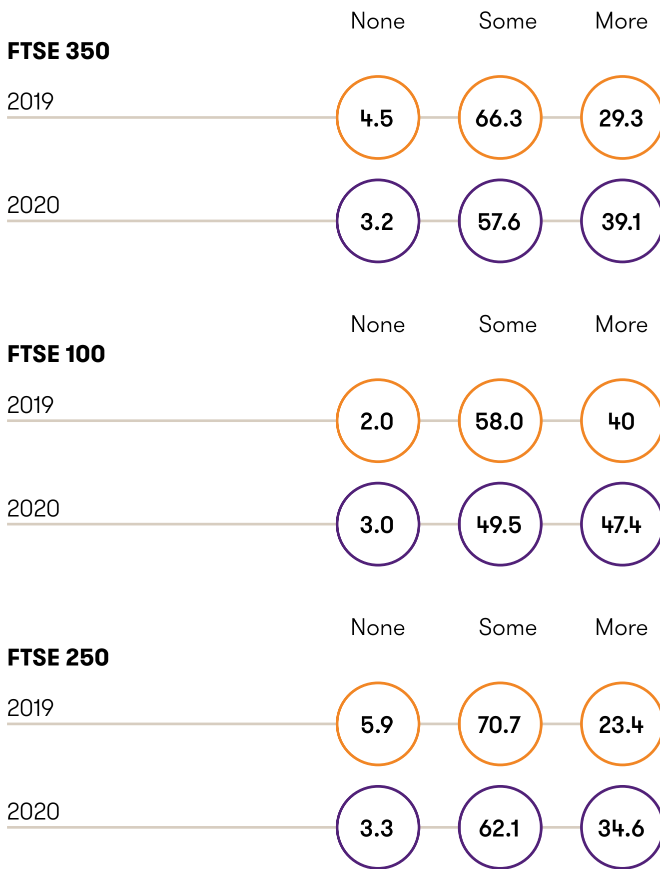




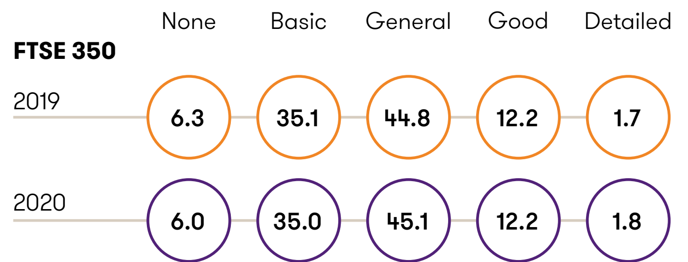
Best practice toolkit - succession planning

Elements/ content	**Things to consider**	**Reporting tips**
Board	The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management. The process of new appointments should be continuous and proactive, not just reactive to tenures. Skills should constantly be mapped to strategy and risks with succession planning and/or learning and development aligned to output.	Provide a skills matrix – linking any skills to the strategy of the company. Provide a timeline showing the evolution of skills in line with strategy. Provide a summary of short, medium, and emergency succession plans in the annual report. Link the perceived needs of the board composition to strategic priorities. This area could also include cross-reference to board evaluation, to demonstrate how the committee identifies gaps in the skills or experience mix of the board. Refer to diversity as a factor in succession planning – this should include consideration on diversity of gender and other demographic and cognitive traits, as well as disability, skills, experience, knowledge, and independence against the stakeholder environment and strategic priorities.
Executive pipeline/ talent development	Ensure there is visibility of the talent pipeline within the boardroom. This should include what systemic actions are in place to encourage and ensure development of diversity (cognitive, female, ethnicity, etc), for example, group coaching and sponsorship. Consider a multi-generational shadow board.	Report on how the board engages with the workforce – spotlighting how the board interacts with high potential talent. Provide details on talent development programmes, highlighting any board level sponsorship.

How much explanation is there of the company's policy on gender diversity in the boardroom? (%)



How much explanation is there of the company's policy on other aspects of diversity in the boardroom? (%)

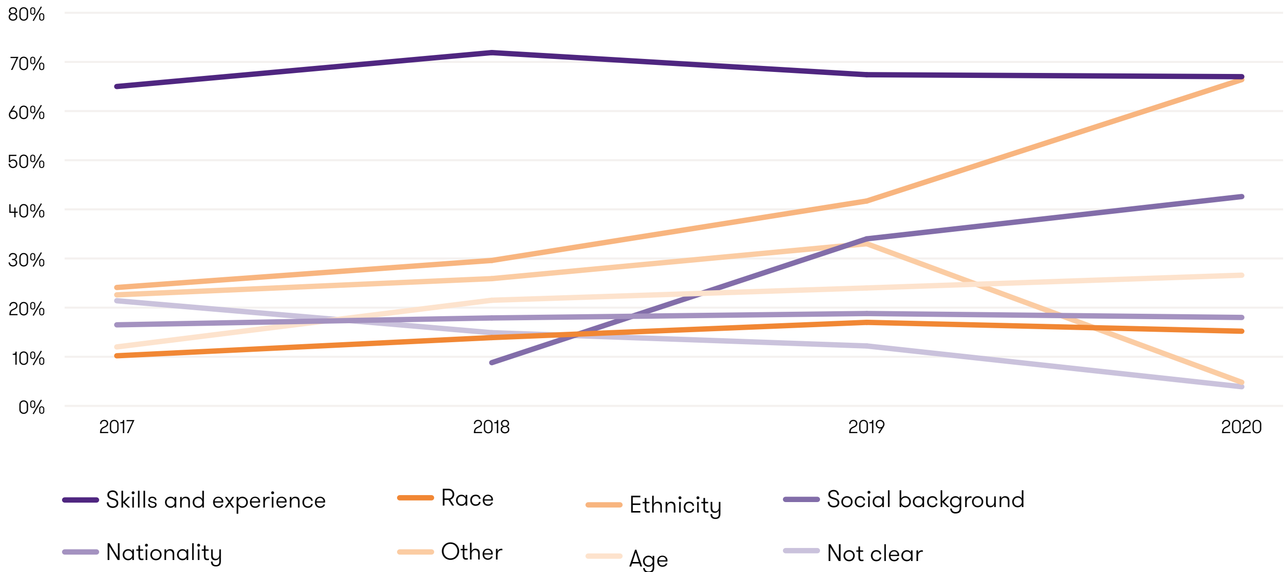


Investor viewpoint

Andrew Ninian, Director, Stewardship and Corporate Governance, The Investment Association

Investors have welcomed the progress that has been made on gender diversity since the establishment of the Hampton Alexander Review, with women now representing over 33% of FTSE 350 boards, and those boards with only one female director having fallen from 74 in 2018 to 16 in 2020. However, this momentum risks being lost if companies don't disclose the breakdown of gender diversity in their senior leadership teams alongside their succession plans. Investors want to understand those succession plans so that they can help companies prepare for the future. Diversity of gender and ethnicity in senior management will be a key area of focus for investors through 2021.

What other kinds of diversity are mentioned? (%)



Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

Increasingly more time is being allocated to forward-planning and consideration as to the right balance of skills, experience and diversity required on all our boards in order to support both today's, as well as the future, needs of the Group. Good succession planning and debate, as well as effective board evaluation, play an important part in this process. Widening the lens on succession planning to multiple levels below the executive team plays an integral role in identifying and bringing through the right balance of skills, experience and diversity for the future of the Group, while applying a longer and more holistic lens to succession planning for our independent non-executive directors will ensure a broader range of succession options for the board and its committees. Ensuring that both the succession planning discussions at the board and the governance and nomination committee, and board evaluations are continuous and dynamic rather than an annual or triennial assurance processes will ensure that the board is well equipped to provide strong oversight in relation to the Group's strategic ambitions and mitigation of emerging risks, and able to respond to changing demographics, skills and working requirements. Providing insight into these areas has been an important part of our disclosures in recent years and we are pleased to have been recognised for the detail provided both on succession planning and the board and committee evaluation themes and outcomes.

Audit committee

68%

of companies now provide good or detailed viability statements

The quality of internal controls reporting has fallen again, particularly in the FTSE 100

66%

of the FTSE 350 provide only basic or general explanation of their review of internal controls effectiveness

32%

have not changed their auditor in more than a decade; this includes 13% which have stayed with the same auditor for more than 20 years

3

chairs of the main board sit on audit committees

In 80% of companies the responsibility for monitoring the risk management process falls to the audit committee. The majority of companies in our review had released their annual reports before the full effects of COVID-19 had been appreciated but the fact that only 18% of companies with 2019 year ends compared to 53% with 2020 year ends had identified a key risk relating to a COVID-19 type event, suggests that many audit committees might want to refresh their oversight process, giving more time to looking beyond the horizon rather than at what is presented to them. With the prospect of a UK-style SOX requirement being introduced, now would be a good time to give more attention to the effectiveness of the systems of internal control and not just the financial ones.

External factors, such as advancing technologies or global events such as pandemics or climate change, are having a major impact on the way business is done. As a consequence, companies' risk profiles are changing. The time, focus and experience required of the audit committee to respond to such changes needs to keep pace.

The audit committee meets on average five times a year – this is a rise from 4.8 last year, likely reflecting increasing challenges in viability reporting in the current environment. We are starting to see additional disclosures which reflect uncertainties and potential volatility caused by COVID-19 – in particular, management's assessment of a company's ability to continue as a going concern. Four companies, three of which are in consumer services, identified material uncertainties as to their ability to do so.

At the same time, there has been a significant rise in the number of companies providing good and detailed viability statements, possibly as a result of the combined efforts of the FRC, the uncertainties created by the pandemic, and the Kingman review's criticism[14].

Three chairs of the board sit on audit committees, contrary to Code provisions. We note that 57 companies (20%) have a stated separate risk committee, including 53% in the financial sector.

Audit committee reporting on the process of assessing the issues, along with key judgments in relation to the financial statements, remains of high quality; with 76% provide good or detailed descriptions.

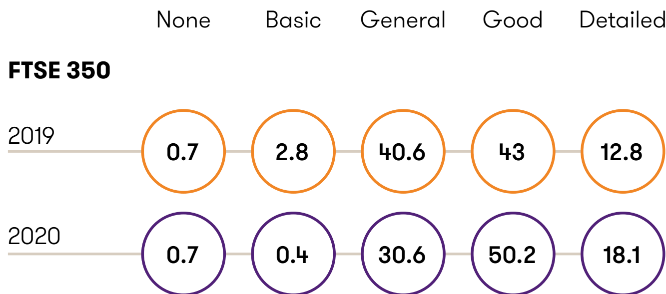
The requirement for companies to explain how they have reviewed the effectiveness of internal controls – rather than simply stating that they have – has finally started attracting more attention since its introduction in 2014. This is likely influenced by publicity about recent corporate failings or the possibility of a Sarbanes–Oxley style reporting requirement for controls assurance[15].

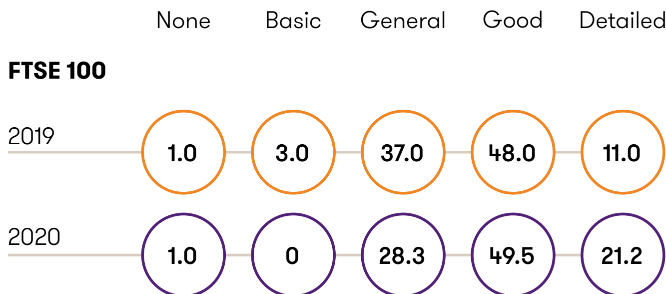
Internal audit is well documented with 92% having an internal audit function - be it in house, co-sourced or out-sourced; 7% give a rationale for not having this function.

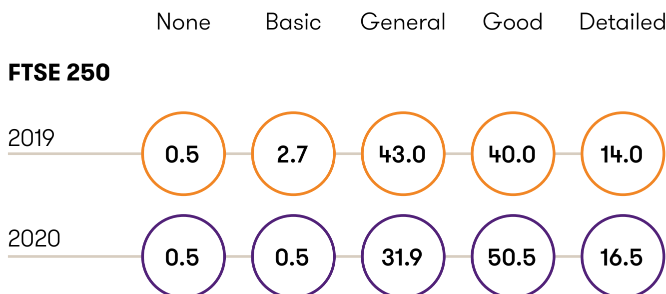
Given the public and regulatory focus on audit tenders – and the process of how audit committees reach their recommendation on the appointment, re-appointment or removal of external auditors – it is also encouraging to see better reporting on this issue. Twenty companies tendered their audit this year, and eleven changed their auditor as a result. Thirty-two percent (32%) of the FTSE 350 have not changed their auditor in more than a decade, including 13% which have stayed with the same auditor for more than 20 years. Overall, the shape of the external audit market has altered very little, with 97% of our population being audited by four firms.

14 The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018
15 The Independent Review of the Financial Reporting Council, John Kingman, December 2018 www.gov.uk/government/publications/financial-reporting-council-review-2018

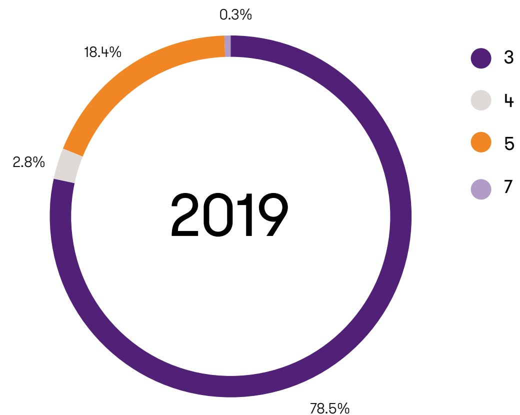
Do companies provide a satisfactory viability statement? (%)

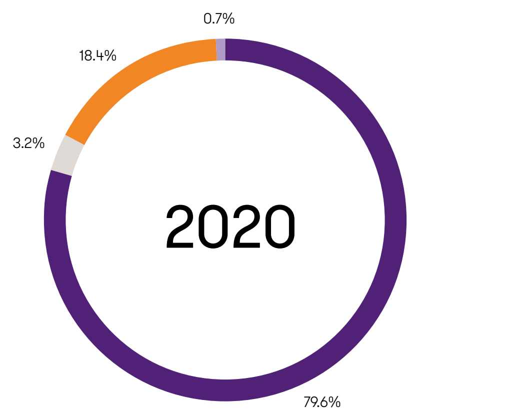






How many years are assessed in the company viability statement? (%)



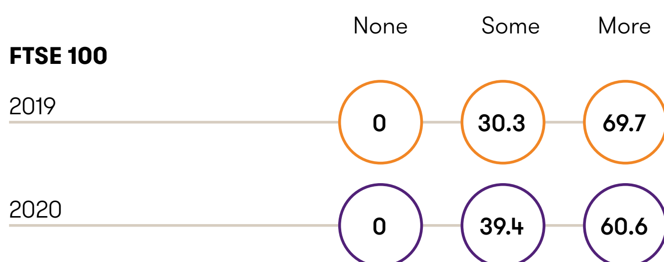


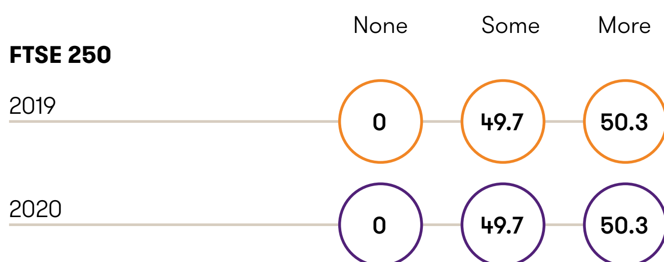
Investor viewpoint

Leon Kamhi, Head of Responsibility, International business of Federated Hermes

An obvious lesson from COVID-19, is the need for strong scenario and contingency planning. Ensuring a buffer is good long term management and should not be seen as inefficient.

How much information is there about the company's internal control systems? (%)



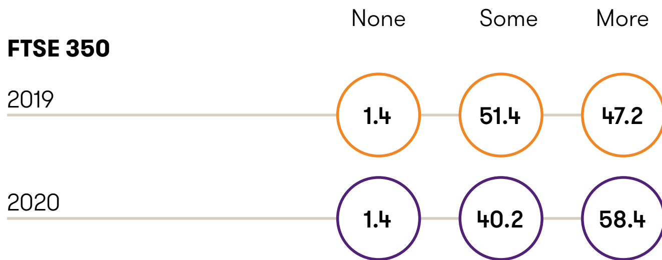


How much information is provided on the process the board have applied in reviewing the effectiveness of the internal control system? (%)

Reporting checklist on reviewing the effectiveness of the internal controls

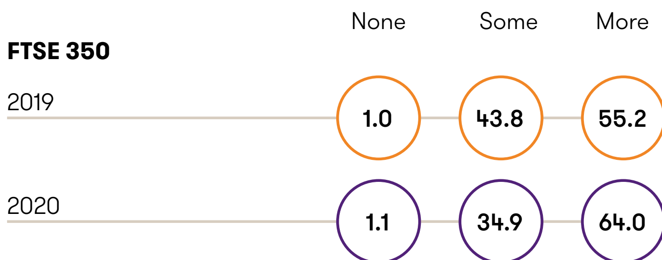
- Areas of the control environment that have been reviewed
  and rationale for selection
- Indicate that operational, financial and compliance controls have been reviewed, if material
- Give specific examples of what it involved
- Method used for analysis (eg reports from management and/or internal audit)
- Mention who was involved in the process
- Outline details of the review of internal control internal guidance documents
- Explain why specific areas were given more detailed review, eg due to the nature of the company or strategic priorities and risks
- Discuss findings and areas for improvement

How much information does the audit committee report provide on how it reached its recommendation to the board on the appointment, reappointment or removal of the external auditors? (%)



FTSE 350	None	Some	More
2019	1.4	51.4	47.2
2020	1.4	40.2	58.4

If the auditor provides non-audit services, is there a statement as to how the auditor's objectivity and independence is safeguarded? (%)



FTSE 350	None	Some	More
2019	1.0	43.8	55.2
2020	1.1	34.9	64.0

Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

As our chairman outlined in this year's annual report, we continue to give particular focus to enhancing our risk management framework, strengthening the conduct environment, risk culture and financial crime compliance infrastructure across the Group. We sought to give further insight through the explanations provided on our improved process and activities in this year's report and the actions required for the future. This included wider management involvement with the audit committee and ensuring that our principal and emerging risks are specific to our business, rather than so broad they become boilerplate disclosures, which supports greater integration of our risk management processes with the business.

Remuneration committee

25%
of companies describe how they have explained executive remuneration to the workforce

22%
of companies do not provide a CEO pay ratio

33%
link their bonuses to non-financial metrics

42%
of companies link annual bonuses or long-term plans to one or more non-financial metrics

71%
of companies do not comply with the Code provision for executive pensions to be aligned to that of the workforce

69%
of companies have introduced or are introducing post-employment shareholding requirements

In recent years the old saying of "what gets paid gets done" has been under increased scrutiny with investors demanding a closer linkage between pay and long-term results and pay ratios between executives and that of the workforce they lead. Governance and regulation have sought to reinforce this with triennial approvals of remuneration policies and seeking to improve the alignment between executive and shareholder interests by extending post-employment holding periods, aligning pension multiples with employees, and malus and claw back policies, to name a few.

What has been slower to catch on is the recognition of the vital role culture plays in the delivery of strategy and sustainable results and that remuneration is a key lever in driving behaviours and shaping culture.

Progress has clearly been made in introducing greater accountability beyond rewarding purely financial results. The gap remains between what businesses say are key imperatives of the business model and the measures by which management are rewarded. The next step is to bridge the gap between the work done to establish and embed cultural frameworks and ensuring that promised and valued outputs are monitored via effective methods and rewards aligned accordingly.

For companies to better meet the overarching requirements of the Code, more strategic and specific metrics, reflective of the business model imperatives, need to be debated and agreed with the institutions. Without this, both parties will continue to make public statements appeasing their societal conscience while continuing to secretly reward the narrow definition of value return.

The quality of remuneration reporting continues to improve. It is now six years since the requirement was introduced for policies to be approved by shareholders every three years; even more companies (52%, 2019: 38%) are clearly stating their engagement with shareholders and noting how this has shaped remuneration policies.

As a sign of improvement, only one company states they have not complied with the requirement, when setting policy, to consider the six factors as outlined in provision 40.

To ensure connectivity and accountability to S172, stakeholders and their strategic connectivity need to be a key consideration in shaping executive remuneration. We have seen a small rise in the use of non-financial metrics for executive remuneration; the tendency here is to use short-term targets linked to annual bonuses, rather than longer-term incentive plans. This may be considered positive by those pushing for executives to recognise wider responsibilities in pursuit of results; but it does suggest a short-term approach, rather than a focus on embedding lasting change.

Regarding stakeholders, the focus on the workforce is bearing fruit. More companies now link remuneration to workforce metrics – whether these relate to culture; health and safety; or other human capital measurements. However, companies rarely link executive rewards to what they say they value and measure their performance against: just 3% use environmental metrics and 1% use social metrics.

Only 14 companies actively include wider stakeholder considerations in their short and long-term incentive plans; 50% of these are financial sector companies. Other key sectors where companies do so are basic materials and utilities; alongside one company each from consumer services and from the oil and gas sector.

The clearest evidence of embedding long-lasting cultural change can be found in financial services, where regulatory intervention is provided by the FCA[16]. This has led to 30 companies in the sector integrating non-financial metrics into their long-term and annual bonus plans.

The requirement to name remuneration consultants reveals further cause for concern, particularly in relation to the call for competition, choice and independence. Two of the largest audit firms provide remuneration consulting services to 52% of the FTSE 350, which, given the long tail many incentive plans have, further restrict the availability of choice when it comes to audit retendering. Whether the current direction of travel for audit separation in firms will make a difference has yet to be seen.

2018 Code

Provision 38 of the Code requires that executives' pensions align with those available to the workforce. Companies seem reluctant to disclose non-compliance with this provision. Only 22 (11%) of the 194 companies that do not align their pensions with that of the workforce actively state this as an area of non-compliance with the Code. Credit to those 22 – who at least have set out a clear timetable by when they intend to have aligned pensions across executives and the workforce (on average c. two to three years).

Another common area of non-compliance relates to the requirement to disclose how companies explain executive remuneration to the workforce. This year, though, the number of disclosures is up: 25% of companies say they have met this requirement (2019: 7%). Provision 33, meanwhile, requires remuneration committees to set remuneration for senior management; 78% of companies (2019: 42%) say they do so.

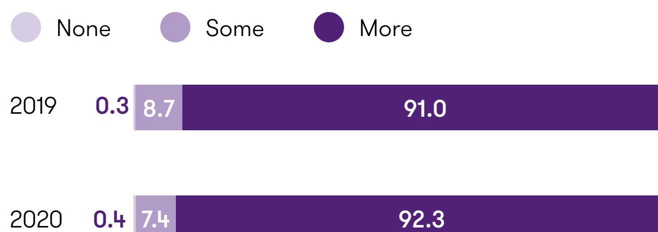
Provision 41 outlines that the remuneration committee report should state to what extent discretion has been applied to remuneration outcomes and the reasons why. Some 91% of companies now claim such a provision, but 24% of these companies do not clearly set out under what circumstances they would exercise this discretion in their policies. See the best practice guidance in this section.

16 We note a letter written by the FCA to the remuneration committee chairs of financial services companies, urging them not to deprioritise culture.

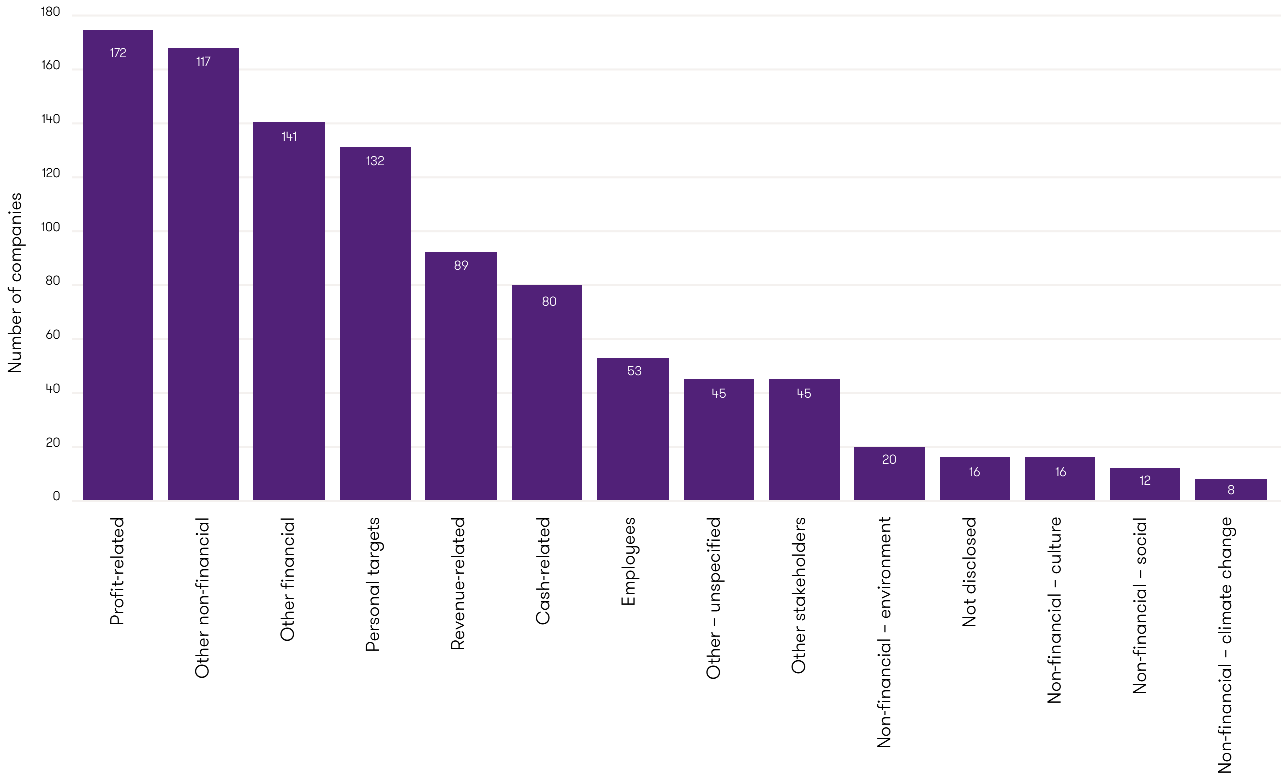
Questions to ask

- How do you ensure executive remuneration is aligned to your purpose, culture and values?
- How do you engage with the workforce on executive remuneration and ensure they feel connected to the company's success?
- What is the board doing to ensure greater alignment between the executive and wider workforce remuneration, including pensions?
- Beyond the workforce, how are other stakeholders reflected in executive remuneration?
- How is the committee ensuring a long-term focus, via executive remuneration, on shareholders and other stakeholders?
- Do the six factors provide an anchor for decisions on executive pay in remuneration committee meetings?
- Do you disclose whether the remuneration committee chair has 12 months' experience before chairing the committee? Only 19% of companies state this at the moment.

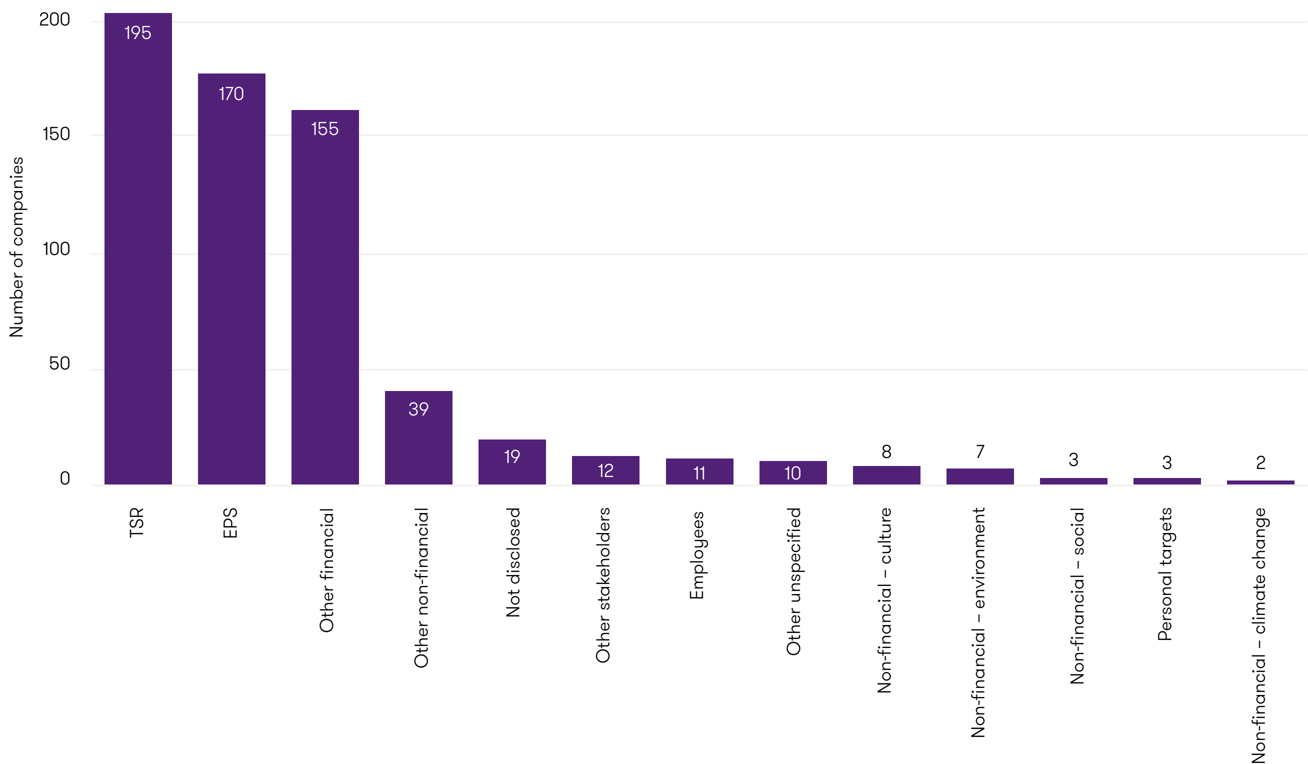
How clearly are companies describing their remuneration policies? (%)

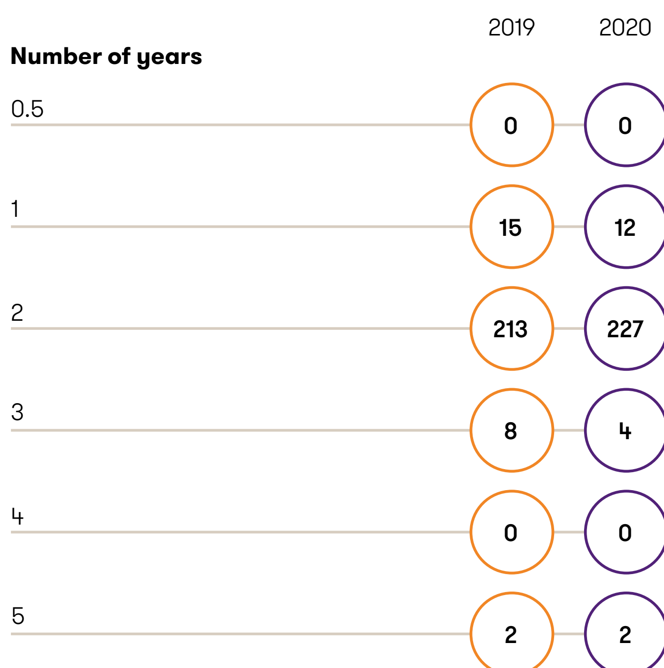


What metrics are used in executive annual bonuses? (number of companies)



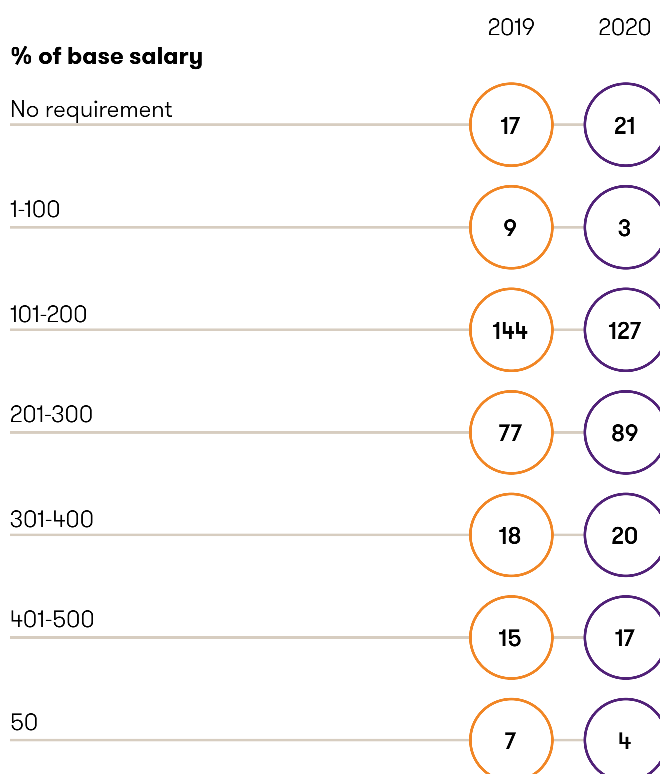
What metrics are used in executive long-term performance-based remuneration? (number of companies)





Retention (additional holding) period of awards after vesting (number of companies)

Number of years	2019	2020
0.5	0	0
1	15	12
2	213	227
3	8	4
4	0	0
5	2	2



What is the minimum shareholding requirement for the CEO? (number of companies)

% of base salary	2019	2020
No requirement	17	21
1-100	9	3
101-200	144	127
201-300	77	89
301-400	18	20
401-500	15	17
50	7	4

Alignment with long-term shareholder interests

To promote alignment with long-term shareholder interests, the 2018 Code includes in its provisions a combined vesting and holding period of five years or more and the use of post-employment shareholding requirements. Current practice has mostly settled on a three-year performance period, followed by a two-year holding period. Sixty-eight percent of companies have either adopted or are adopting post-employment shareholdings in their remuneration policies.

The most popular long-term incentives are performance share plans, with 93% of companies saying they follow this approach. Six percent of companies use restricted share plans, with half having these as well as a performance share plan. Ten percent of companies use other types of incentives such as deferred share plans; a large number have this as well as other incentives such as performance shares.

Investor viewpoint

Leon Kamhi, Head of Responsibility, International business of Federated Hermes

Executive remuneration needs to get simpler and focus on the underlying health and performance of a business which should factor in all key drivers including relevant social and environment factors. Schemes should be less leveraged and the explanation from the board on why a remuneration outcome is justified should be self-evident.

Is there a clawback provision? (%)

	2019	2020
Yes – bonus and PSP	83.0	87.9
Yes – bonus	5.2	4.3
Yes – PSP	3.8	2.1
No	8.0	5.7

Does the description of the work of the remuneration committee include the details of what engagement has taken place to explain how executive remuneration aligns with the wider workforce (%)

	Yes	No engagement	Not disclosed
2019	8.6	68.1	23.3
2020	24.9	50.9	24.2

Does the description of the work of the remuneration committee include the details on what engagement has taken place with shareholders and the impact this has had on remuneration policy and outcomes? (%)

	Yes	Yes – engagement only	No
FTSE 350	52.7	32.7	14.6

Are executive pensions aligned to workforce pensions? (%)

	Yes	No	Not disclosed
FTSE 350	28.9%	60.7%	10.4%
FTSE 100	27.3%	68.7%	4.0%
FTSE 250	29.8%	56.4%	13.8%

Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

This year's annual report also demonstrated continued improvement in the clarity of remuneration disclosures. This addressed feedback from stakeholders that disclosures provided in previous years, while considered fulsome, were also somewhat complex. The disclosures provided this year sought to make the component parts of our reward framework clearer and demonstrate how our executive director reward aligns with the wider workforce and how this had evolved over time. Investor feedback was positive, acknowledging our response to their feedback. We also published our first external Fair Pay Report this year, building on the work we have done since 2018 to embed our Fair Pay Charter.

Best practice toolkit - remuneration

Elements/ content	**Things to consider**	**Reporting tips**
Link to strategy	Consider how executives are driven to deliver on strategy.	Align each strategic pillar to an element of remuneration. Explain choice of metrics linking these to strategy per the above.
Link to culture	Think how reward can help to promote right behaviours.	Report on how the board engages with the workforce over the link between executive remuneration and company culture. Include culture-related metrics to incentives for directors for example if it is a customer-centric culture, then include customer-related metrics. Signpost linkage to values.
Use of discretion	Consider impact of COVID-19.	Dedicate a subsection of the Committee report to the use of discretion. Provide sufficient detail on the use of discretion due to pandemic to better link it with the workforce remuneration. Describe details of engagement with shareholders over levels of discretion if any. Report meaningfully on any changes to remuneration in the year such as pay cuts. Shareholders can see through any obfuscations! Report on scenarios under which discretion can be used, providing examples if appropriate.
Workforce engagement	Workforce considerations in executive pay determination.	Report on the means of engaging with the workforce over executive remuneration. Demonstrate how the company explains alignment of executive pay with the workforce, providing feedback if any. Report on how you factor in relevant data such as gender pay gaps, pay ratios within the context of executive remuneration outcomes.
Shareholder engagement	Shareholder input in remuneration policies and outcomes.	Report on: • meetings held with shareholders stating who the committee met with and content of meetings. • feedback received and the company's response. • changes made as a result of engagement also providing a strategic context.

Annual report and quality of reporting

6%

The total number of annual report pages, average 11 pages

11%

increase in the number of strategic report pages

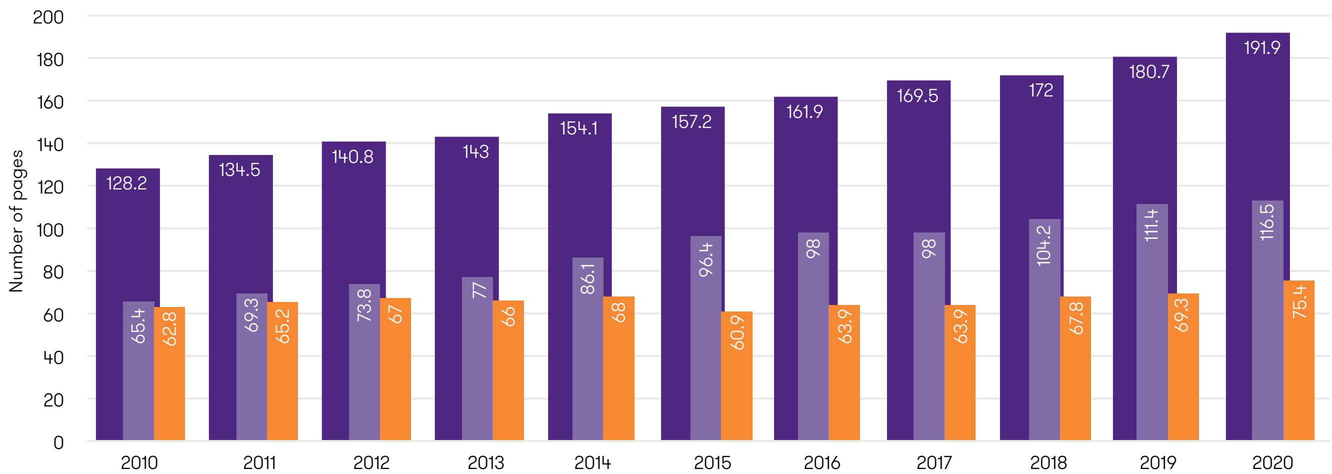
35%

provide good or detailed explanations as to why their annual report is fair, balanced and understandable

The volume of information in an annual report continues to expand; the average page count is now 191.9, up 11 pages. But for the first time in years, more pages have been added to the financial section of the accounts – that is, the back end (6 pages). The FTSE 100 has an average page count of 224 pages (2019: 211) while the FTSE 250 has 175 (2019: 165). Four FTSE 100 banks have the largest number of pages, at an average of 350. Some areas have seen significant rises in page count; these include risk; corporate social responsibility; stakeholder engagement (with the strategic report and governance report) and remuneration reports.

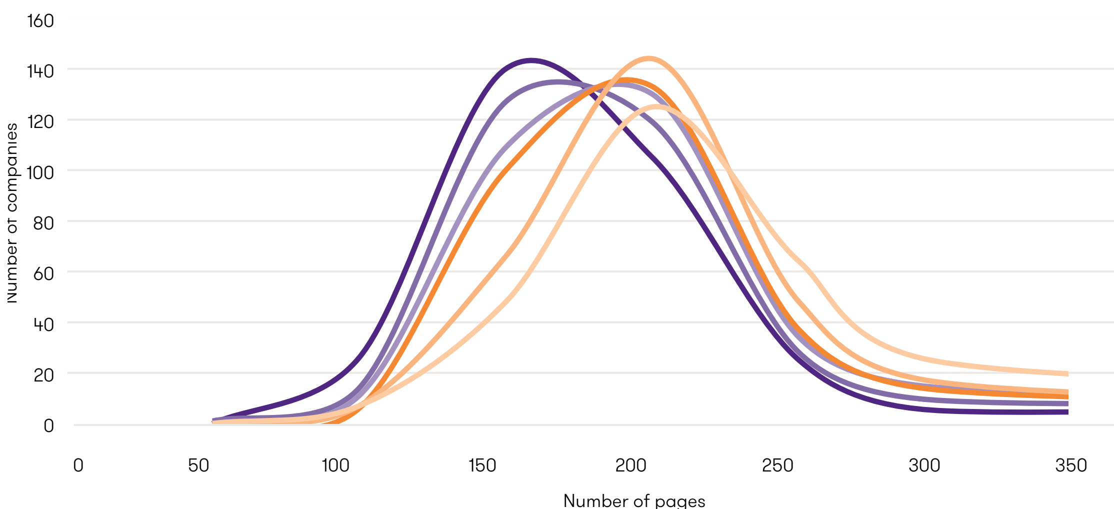
Average length of annual report

Annual report Front end Back end

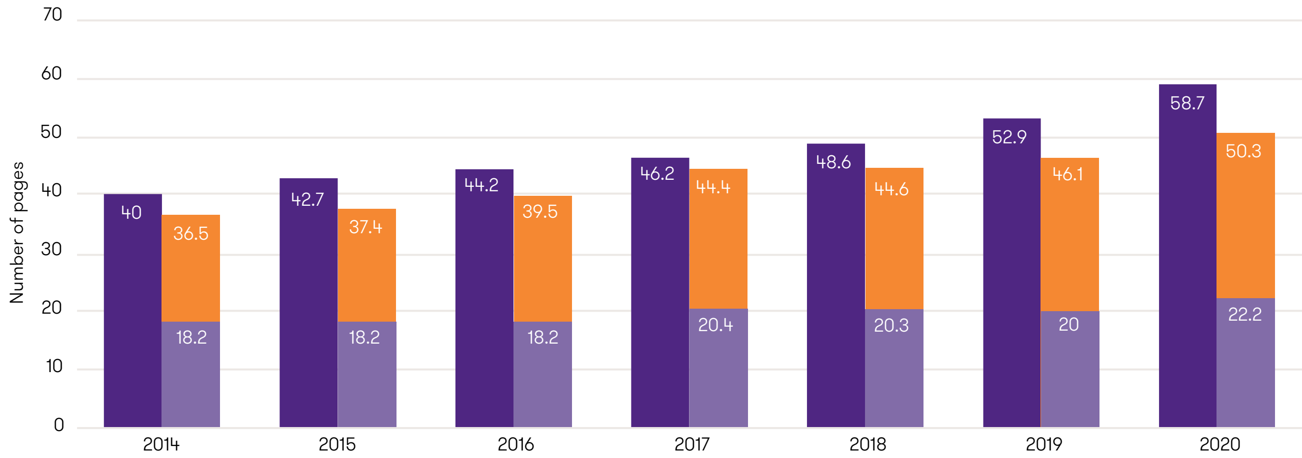


Length of annual reports for the FTSE 350

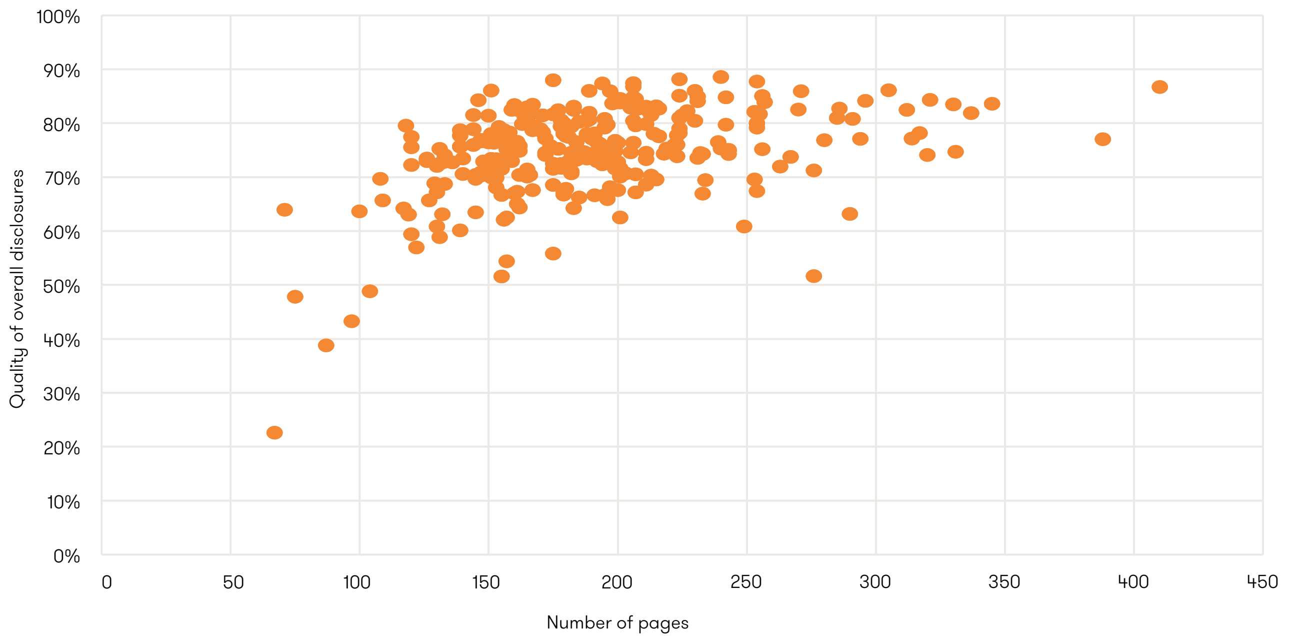
2015 2016 2017 2018 2019 2020



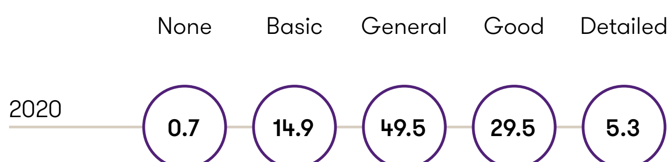
Average length of front end



Length of annual reports and disclosure quality (2020)



How much information does the board provide as to why it considers the annual report fair, balanced and understandable? (%)



In Principle N, the 2018 Code states that the board should present a fair, balanced, and understandable assessment of the company's position and prospects.

All bar two FTSE 350 companies (2019: all but two) say they consider their report fair, balanced and understandable. The quality of explanation has remained constant, with 35% (2019: 34%) saying how they have come to this conclusion.

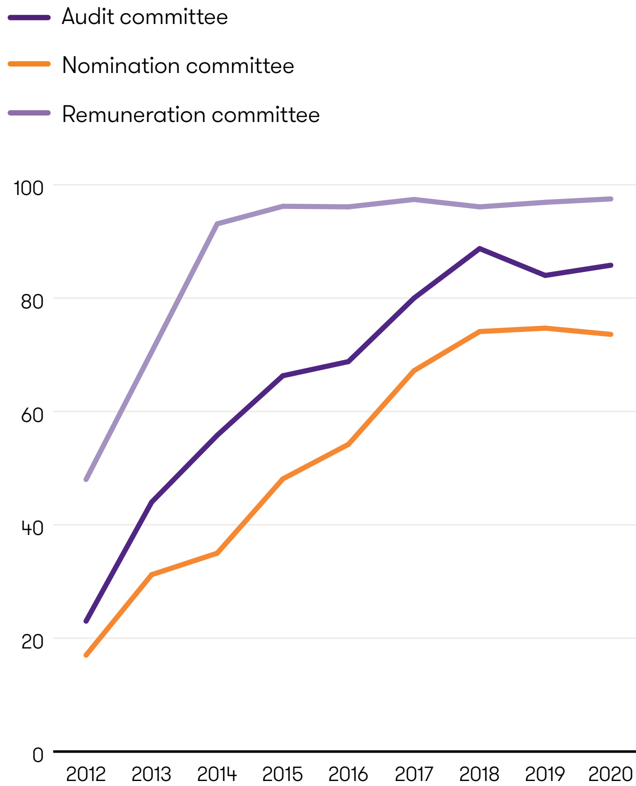
With an average of 192 pages, increasing technical content in the back end and an already extensive front end, the accounts have long been lost to ordinary investors wishing to gain a fair and balanced understanding of the company their pension is invested in. As demand increases for more information that is both transparent and understandable, so the pressure grows for clearer guidance on what information should be presented in the annual report. It is surely time that accounts are stripped back to provide the basic information on which third party assurance can be provided – or which contributes to an understanding of how the organisation is controlled and governed with the remainder posted on the company's website.

Governance viewpoint

Amanda Mellor, Group Company Secretary, Standard Chartered Bank

We are just about to start the drafting for this year's report which will provide insight into the effectiveness and agility of the Group's governance processes in the face of the huge challenges and impact of COVID-19. The drafting process always causes us to reflect not only on what we have achieved in the year to close, but also on the progress we would like to make in the year ahead. We are already reflecting on potential changes to diversity reporting and stakeholder engagement and will be looking to incorporate any changes in the forward calendar of the board's activities in order to be able to report back in twelve months' time.

Personal commentary from the chair (% Yes)



Personal commentaries from committee chairs are important to provide an overview of the accountability and workings of the respective committee. There are no surprises in this year's data. As the 2018 Code requires committee chairs to engage directly with shareholders and with the wider stakeholder focus, personal statements could provide an avenue to explore some of these themes.

Investor viewpoint

Leon Kamhi, Head of Responsibility, International business of Federated Hermes

In all their communications including the annual report, companies should not lose sight of the importance to of telling their story in a clear and convincing way and not be distracted by the pressure to box-tick.

Preparing for 2020 and 2021 year-ends

Preparing for 2020 and 2021 year-ends

This year's research reveals encouraging trends and opportunities for engagement, but there have also been new and emerging challenges – including the COVID-19 pandemic, an economic recession and wider public considerations. In preparing for 2020 and 2021 year-end reporting periods, businesses need to plan and consider how they integrate output in order to simplify, demonstrate accountability and transparency in decision-making and outcomes, while providing sufficient information around the leadership and value creation 'USPs'.

Responding to COVID-19

Maintaining shareholder and stakeholder confidence, with greater engagement and communication on COVID-19 and its associated impacts is key. Additional disclosures in specific areas will be beneficial: risk management strategies, for example, might provide investors with key information about resilience and adaptability to internal and external shocks.

Continuing COVID-19 spikes could cause further uncertainties and potential exposure to volatilities – so, in disclosing the management's assessment of the companies' ability to continue as a going concern, companies should expect to provide more details about specific elements of uncertainty; consideration of resulting impacts; and current and future actions.

More companies now offer details of specific scenarios considered and key assumptions used in their viability statements. In the context of the current environment, investors will want to understand if companies may need to take more fundamental and radical action if they are to remain viable.

Applying the principles

Considering the drop in compliance rates this year, and the new Code's focus on the application of the core principles, companies will need to provide better insights into their governance practices, specifying actions and outcomes. Only 32% give meaningful descriptions on applying the principles this year.

There is now a chance for a fundamental shift in how companies report and communicate with stakeholders – but building and retaining an atmosphere of transparency and trust requires leadership and commitment from the board.

Improving the quality of the front end reporting can go a long way to strengthening that trust.

Business purpose

As well as underpinning a business's 'licence to operate', purpose is intended to shape a better business. It does this by providing discipline to strategy; some companies may also set formal objectives to help achieve their purpose, or to articulate how strategic outcomes flow from it.

But establishing purpose requires a deep and wide-ranging review of the business, with engagement of both employees and much of the wider stakeholder community – otherwise, leaders run the risk of reinforcing their own beliefs. For purpose to be genuine, it needs to have at least explored stakeholders' expectations. This commitment differentiates those who have set out on a new journey from those who are merely rebranding the past.

A resulting challenge is how to measure progress towards purpose – as this cannot be done directly. One way can be to set up proxy indicators, to understand how purpose is changing internal and external relationships – and how it leads to specific financial, environmental and social outcomes.

ESG considerations

Although companies are making better environmental and social disclosures, there is little evidence that they are integrating these issues into the heart of business strategy and making the link to purpose. Businesses should focus on these matters – which include climate change; workforce diversity in the context of long-term risks; strategic priorities; and executive remuneration.

In long-term incentive plans, just 3% of companies use environmental metrics, 4% employee measures and 1% social metrics. So, companies need to better link executive rewards to what they say they value – and apply this when it comes to the remuneration committee's use of discretion. The remuneration committee chair has a significant role to play in ensuring that shareholder and employee voices are heard.

Stakeholder engagement

Companies are more mindful of the impact of their decisions on key stakeholders, as indicated by the fact that 77% of the FTSE 350 have provided their section 172 statements with a varied level of detail and linkage to other disclosures.

But to meet the new statutory principles further strategic consideration is required on impact, feedback loops and incentives. Companies need to explain what significant issues their stakeholders raised, and how it informed decision-making. They should also show integrated thinking, giving extra detail and tangible examples of how stakeholders' expectations were considered in board decisions; and illustrate the long-term impact of these decisions.

Culture

Although companies better explain different aspects of their culture, boards face a challenge in ensuring that what they are hearing and espousing truly reflects what is happening throughout the organisation. A single data source is unlikely to enable the board to monitor culture at all levels of the company, in a reliable and consistent way.

Companies must decide what works best for them: be it a bespoke dashboard or scorecard with different indicators consistently applied; ideally, a combination of metrics and methods which they can monitor over time and then follow it up with a form of culture audit to affirm their own assessment.

Boards fit for the future

The new Code gives the nomination committee a greater role to play in addressing emerging skills needs, meeting the challenges of diversity, and planning for succession below board level. Few companies outline how they are future-proofing themselves, or have already done so, by recruiting or developing the knowledge and experience needed: 82% give little or no insight into the development of the executive pipeline and senior management succession.

Addressing the succession of chairs and considering wider issues of diversity are further hurdles: 80 chairs have either been on the board for more than nine years or are approaching this deadline; only 17 chairs are women.

Effectiveness evaluations may help make boards fit for the future, but this year's disclosures indicate a need for more innovative approaches and explicit company reporting on follow-up actions.

Better, not more

This year's growth in annual report length reflects not only how companies are trying to respond to the new Code, but also the COVID-19 pandemic. Yet some companies seem to be taking a box ticking approach as opposed to thinking through the application relevant to their business model and strategy.

Our research shows there is no strong correlation between the number of pages and the quality of disclosures.

In addressing the challenges, companies should ensure that information is not just added, but integrated with other information to give a holistic picture of the business. A new narrative approach would be an ideal solution – but a more realistic challenge might be to reduce 10% of content, limit the use of images that are cosmetic and extract non-essential information that can be provided with more detail on their website.

For information on how we can help assess the quality of your annual report, please contact us.

Recent and forthcoming developments

	Comments	Timing	Mandatory reporting in the annual report?
Corporate governance reforms			
The Companies (Shareholders' Rights to Voting Confirmations) Regulations 2020	Requires electronic confirmation to be sent to the shareholder of a traded company on receipt of an electronic vote and when requested, the provision of information which enables a shareholder to confirm that their vote taken by a poll in general meeting has been validly recorded and counted	3 September 2020	
Corporate Insolvency and Governance Act 2020 (GIGA 2020) (Coronavirus) (Extension of the Relevant Period) Regulations 2020	The Act introduced permanent and temporary measures to the insolvency and companies house filing regimes because of COVID-19. It also introduced temporary changes to both the timing and conduct of general meetings of qualifying bodies allowing greater flexibility about the manner in which meetings are held (for example, companies can hold meetings, and allow votes to be cast, by electronic means) and temporarily eased company filing requirements. The Regulations extended the duration of some of the temporary measures introduced by the Corporate CIGA 2020 beyond their expiry date of 30 September 2020 including an extension to the period within which companies must hold an AGM. Companies with a deadline for holding an AGM expiring between 26 March 2020 and 30 December 2020 have until 30 December 2020 to hold their AGM. The Secretary of State also has the power to extend that period by up to three months at a time, but the temporary period cannot be extended beyond 5 April 2021. Also, further extensions have now been granted in relation to filing periods.	The Act effective from 26 June 2020; the Regulations effective from 29 September 2020	
Navigating COVID-19 – FRC and other guidance			
FRC COVID-19 Thematic review	This report summarises the key findings of a review of the financial reporting effects of COVID-19 for a sample of interim and annual report and accounts with a March period year-end. It found that companies generally provided sufficient information on the impact of COVID-19 on the company's performance, position, and prospects. However, there several areas for improvement highlighted including going concern disclosures. The FRC found that the best disclosures were specific to the company and provided additional information clearly explaining how COVID-19 impacted the company's reported position and performance and how it may affect future prospects	Published July 2020	This is helpful guidance for the preparation of interim and annual reports. However, it is noted that as the COVID-19 situation is evolving rapidly, some of the examples and guidance in the report may be superseded as more interim and annual reports covering longer COVID-19 impacted periods are published

	Comments	Timing	Mandatory reporting in the annual report?
FRC Reporting Lab – COVID-19 – Resources, action, the future	This report provides insights in respect of current reporting practice and the effect of COVID-19 covering: **Resources** – including the availability of cash and short-term financing **Actions** – to manage short-term expenditure and ensure viability; and **The future** – how decisions taken now ensure the sustainability of the company and impact customers, suppliers and employees. The report includes specific examples helping companies to answer five current questions that investors are seeking information: **Resources** 1 How much cash does the company have? 2 What cash and liquidity could the company obtain in the short-term? **Action** 3 What can the company do to manage expenditure in the short-term? 4 What other actions can the company take to ensure its viability? **The future** 5 How is the company protecting its key assets and value drivers?	Published June 2020	Part of the 'Reporting in times of uncertainty' series. Lab reports do not form new reporting requirements. However, they do provide a useful reference for good practice in addressing the information needs of investors from annual reports
FRC Reporting Lab – COVID-19 – Going concern, risk and viability	This report highlights key considerations for companies in each of the above three areas of disclosure. The report also provides examples of current disclosure practices	Published June 2020	Part of the 'Reporting in times of uncertainty' series. Lab reports do not form new reporting requirements
National Audit Office – Guide for audit and risk committees on financial reporting and management during COVID-19	This guide aims to help audit and risk committees of public sector bodies discharge responsibilities in several areas including annual reports, financial reporting, the control environment, and regularity of expenditure. Includes questions to help committees understand and challenge activities	Published June 2020	Good practice guide. Does not form new reporting requirements
Investment Association (IA) – Executive remuneration in UK listed companies – Shareholder expectations during the COVID-19 pandemic	It covers executive pay and the linkage to shareholder experience considering the pandemic. Areas addressed include dividend suspension/cancellation & bonus outcomes; performance conditions and outcomes for variable incentives	Published April 2020	IA viewpoint on how remuneration committees should reflect on executive pay during the pandemic. Guidance will be updated as the situation develops
Sustainability/Climate-change			
EU Taxonomy Regulation 2020	It is designed to help identify which economic activities and investments can be treated as environmentally sustainable, providing certain criteria to be fulfilled. The taxonomy is to play an important role in the development of green finance and in preventing greenwashing. Large public interest entities subject to the EU non-financial reporting directive from 1 January 2022/2023 must include in their non-financial statements how and to what extent its activities are associated with economic activities that qualify as environmentally sustainable. It is not clear if the UK will implement the taxonomy after the Brexit transition period	Entered into force 12 July 2020	

	Comments	Timing	Mandatory reporting in the annual report?
Climate Financial Risk Forum – Guide to climate-related financial risk management	Co-chaired by the FCA and the PRA, the forum aims to advance the sectors response to financial risks from climate change. The guide contains 4 industry-produced chapters covering disclosure, innovation, scenario analysis and risk management and a summary provided by the FCA and PRA	Published 29 June 2020	Guide to help financial services firms understand the risks and opportunities that arise from climate change and provides support for integration into risk, strategy, and decision-making processes.
European Reporting Lab – How to improve climate-related reporting	This report is the first project of the European lab on climate-related reporting. Prepared by the Project Task force on Climate-Related Reporting (PTF-CRR) it identifies good reporting practices and implementation of the Task Force on Climate-Related Financial Disclosures (TCFD) in Europe including the United Kingdom. Supplements include a general review of climate-related disclosures and an in-depth review of scenario analysis reporting	Published February 2020	Supports the practical application needs of corporate reporting stakeholders
FRC Reporting Lab – Climate-related corporate reporting	Provides guidance for companies on how reporting on climate change can be improved. Recommends that companies use the TCFD	Published October 2019	Lab reports do not form new reporting requirements
Diversity			
Board diversity	For years, the Hampton-Alexander Review team has been promoting female representation in leadership positions of British business. It has broadened the ambition to the entire FTSE 350, and raised the target to 33% of women on board by 2020. The focus for the work on the gender pipeline will be on representation on executive committees and direct reports to the executive committee The fourth report was published in November 2019. On FTSE 100 boards, 32.4% of directors are female giving hope that the target of 33% is likely to be met ahead of the December 2020 deadline. The FTSE 250 is not far behind at 29.6% female representatiton. However, the pace of change in leadership roles is described as too slow, as if the current progress continues, the FTSE 350 will miss the target for executive leadership and their direct reports. In October 2017, the Parker Review committee, led by Sir John Parker, released their consultation report: Beyond one by '21: examining the ethnic diversity of FTSE 350 boards. The report recommends that FTSE 350 boards should have at least one director of colour. Nomination committees are expected to acknowledge this target and provide relevant disclosures in their annual reports.	The target is 33% women on boards, executive committees, and their direct reports by 2020 for all FTSE 350 companies The report recommends that FTSE 100 boards should have at least one director of colour by 2021 and FTSE 250 by 2024.	The Reviews set recommendations. Reporting on diversity policy, its targets, linkage to strategy and progress is required in line with the UK Corporate Governance Code.
Workforce Reporting			
FRC Financial Reporting Lab – Workforce-related corporate reporting	This project looks at how companies might meet the needs of investors in the context of reporting on the workforce	Published January 2020	Lab reports do not form new reporting requirements

Governance and board advisory services

Benchmarking and best practice guidance

What governance practices concern you the most? Would you like to see how you compare to best practice? Do you know how your current practices align with new or upcoming governance codes and requirements?

Find out what you could learn from others in your sector or those you hold in high regard.

We have 19 years of experience in assessing the front end of annual reports against Companies Act requirements and UK corporate governance codes. We have a unique best practice database that holds more data than any other UK governance researcher.

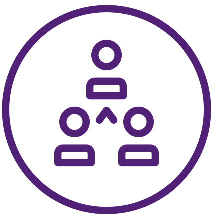
Our insights will show you how your governance practices, as evidenced through decision-making structures, communications and reporting, compare to your peers and relevant corporate governance codes, and help you develop them to be fit for purpose.

When is it relevant – Organisations experiencing fast growth, significant change, or simply looking to improve existing practices, so they are fit to deliver against the strategic objectives and the stakeholder environment.

Value add to client – Identifying any gaps in applied and communicated governance structures to highlight areas that may lead to inefficiency and impact value.

Types of solutions

- Gap analysis against new guidance
- Benchmark reporting against good practices and recognised governance codes
- Identification of areas for improvement and strengthening
- Detailed insights on governance practices for stakeholders such as lenders and investors
- Board and SMT training and update programmes



Governance restructuring

While strategy is regularly reviewed, measured, and refined, rarely are the governance elements that frame the decision-making environment kept in alignment.

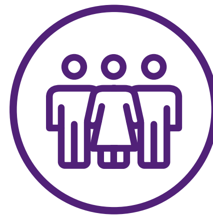
Governance structures are critical to ensure effective decision-making, efficient use of capitals and enable a greater pace of change in order to deliver sustainable outcomes.

When is it relevant – Rapid growth, issues around the implementation of strategy, a significant change event which renders your current governance framework no longer fit for purpose, or part of a regular review to ensure you the right structures are in place to deliver stability in a volatile economic environment.

Value add to client – We facilitate the design and implementation of appropriate governance frameworks which balance the greater needs of all stakeholders, manage risk, enable performance, and support innovation.

Types of solutions enabled with management

- Governance/organisational design
- Development of frameworks, policies and procedures
- Group risk appetite identification and embedding
- Internal control reviews and redesign
- Performance and incentivisation measures, restructuring and implementation
- Board and SMT evaluation and development
- Cultural measurement and assurance
- Support designing governance frameworks that align to strategy



Board effectiveness

For an organisation to deliver sustainable outcomes for stakeholders, the board needs to act as a cohesive leadership team whilst also maintaining a dynamic tension from within. You want to do things right and do the right things. The first job of any external board review is to make sure you've got the basics covered, and you're not putting at the established value created at risk. Equal attention should be paid to the dynamics and the learning and development of the board, in light of the organisational strategy. If the dynamics in the boardroom aren't working, it can undermine the benefits of diversity of thought and individual skills and, ultimately, how effective the board is in adding value to the organisation.

When is it relevant – As well as the recognised formal three-year cycle of independent board reviews, companies are looking for a dynamic and more frequent process, which supports succession planning, learning and development and team processes which underpin effective ways of working.

Value add to client – External assurance over the board in terms of structure, capability and function, and a fresh perspective on how the board can sustain high performance. Key contributor to developing future leadership succession.

Types of solutions

- Independent board effectiveness reviews
- Dynamic online surveys to support both external and internal reviews
- Secretariat support
- Board meeting coaching
- Facilitation of retreats and away days
- Team effectiveness and individual skills diagnostics
- Stakeholder performance dashboards
- Board training, regulatory compliance, and governance workshops
- Benchmarking

How we can help

Our governance and board advisory team brings its board governance and shareholder relations team together with business psychologists, executive coaches and leadership development specialists.

We support organisations in shaping fit-for-purpose governance structures that build trust and integrity with stakeholders; ensure dynamic performance through leadership for the future; and create environments in which their people and operations can thrive.

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Corporate governance review 2019

Getting smart about governance

Corporate governance and company performance

Unlock - Enhance your board's potential

For further information, visit: **grantthornton.co.uk/governancematters**

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