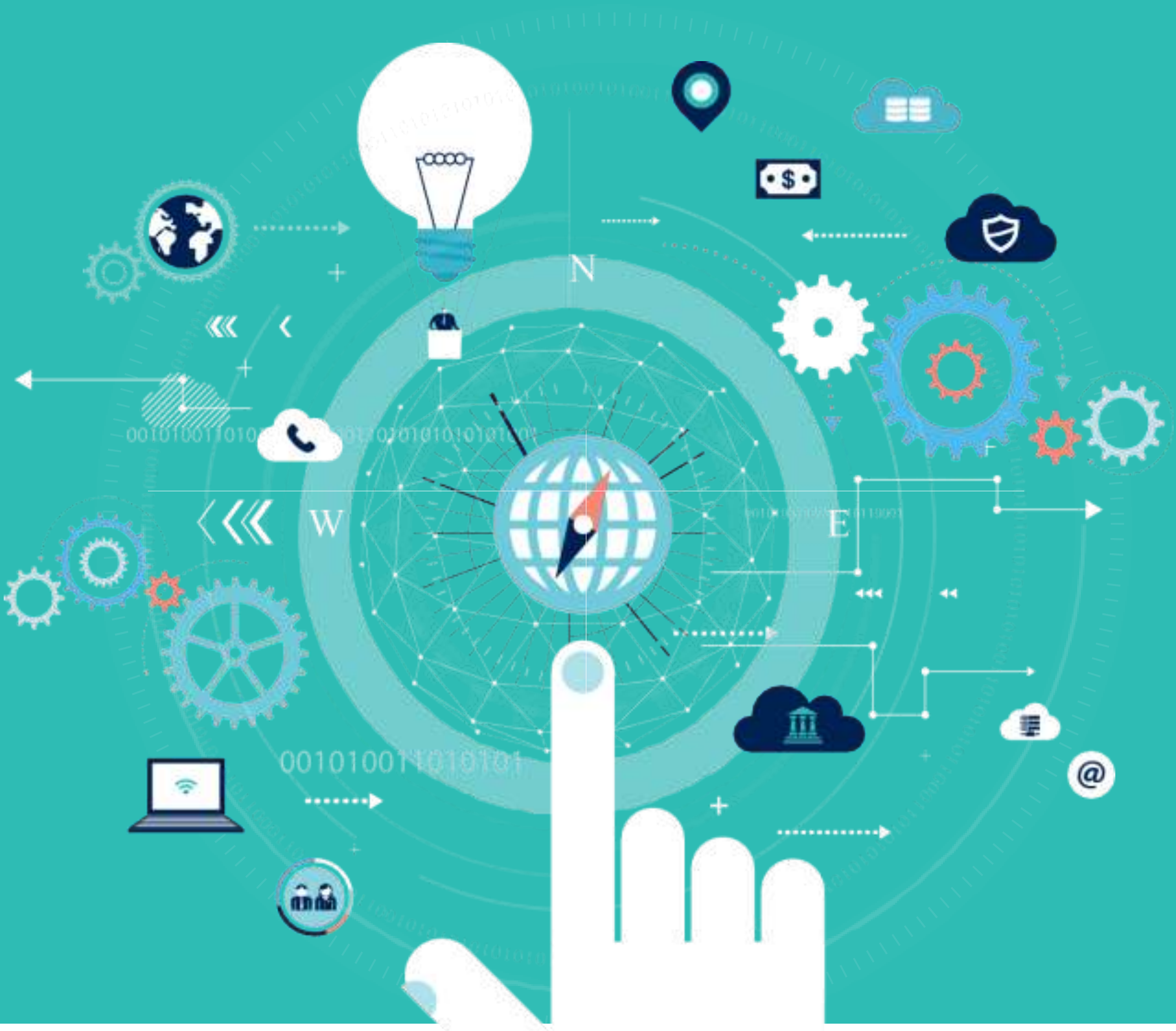
THE INVESTMENT ASSOCIATION

SHAREHOLDER PRIORITIES FOR 2020 – SUPPORTING LONG TERM VALUE IN UK LISTED COMPANIES

JANUARY 2020



About the IA

The Investment Association is the trade body that represents UK investment managers, whose 250 members collectively manage over £7.7 trillion on behalf of clients. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs. The UK is the second largest investment management centre in the world and manages 37% of European assets.

Investment Association (IA) members hold in aggregate, one third of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account. More information can be viewed on our website.

About IVIS

The Investment Association's Institutional Voting Information Service (IVIS) is a corporate governance research service which analyses FTSE All Share and FTSE Fledging companies against the IA's investee company guidelines, the UK Corporate Governance Code and best practice.

IVIS does not provide voting recommendations and instead assists shareholders to make informed voting decisions by highlighting issues or concerns prior to voting. Each IVIS report is issued with a colour top: blue, amber or red. A blue top indicates no areas of material concern while an amber top raises awareness of areas which require a significant shareholder judgement. A red top is IVIS' strongest level of concern and used to highlight a breach of best practice or our guidelines.

About the Public Register

The IA's Public Register is the world's first register tracking shareholder dissent at listed companies. The Public Register details companies in the UK FTSE All Share that have received significant opposition (20% of votes cast or more) by shareholders to any resolution at their AGM, or any resolution withdrawn before a shareholder vote.

The Public Register tracks how companies are responding to such dissent including whether they commit at the time of their AGM to take further action and whether a company has provided an update statement. The UK Corporate Governance Code requires an update statement within six months of the shareholder meeting, describing the engagement the company has undertaken since the vote to understand shareholder views and any potential actions that have emerged or been taken.

INTRODUCTION

Investment managers are investing on behalf of millions of savers in the UK and around the world, seeking to deliver long term returns which meet their investment needs. One way they do this is by ensuring the companies which they invest in are run to generate long term returns for shareholders and ultimately savers. Ensuring that companies are well governed and are addressing material risks to their long term health is a vital part of the investment process because companies that effectively manage these risks are more likely to deliver the best results for shareholders and savers.

Investment managers have high expectations of UK listed companies. These expectations are not limited to share price performance or dividend yield. Instead, investors adopt and encourage a more holistic approach to stewardship; expecting companies to be cognisant of a wide range of material issues including environmental, social and governance issues which, when pro-actively and smartly managed, can lead to the long term returns investors and savers seek.

This year the IA has developed expectations on four areas that members believe can be critical drivers of long-term value:

- Responding to Climate change
- Audit quality
- Stakeholder engagement, and
- Diversity.

The risks presented by **climate change** to business, society and the environment are becoming increasingly clear and the need for investors and companies to act with urgency to address these risks is undeniable. Individual savers are increasingly alert to the impact of climate change on their investments and are rightly setting high expectations of how asset owners and investment managers are taking them into account. Governments and regulators are accelerating their scrutiny of progress towards the Paris agreement and achieving net zero carbon emissions. All eyes will be on the UK to demonstrate leadership in the run up to the UN's climate change summit, COP26, which it hosts in November 2020. The IA is therefore working closely with its members and others stakeholders to address these challenges as a policy priority for 2020. This will involve more scrutiny on how companies are managing the risks climate change poses to their business and how they are responding to these risks and opportunities.

Companies need to proactively identify and take action to manage climate related risks to their business and make the necessary disclosures to reflect these actions. In 2019, the UK Government's Green Finance Strategy recommended that all listed companies should disclose in line with the Taskforce for Climate-related Financial Disclosures (TCFD) by 2022. Investors want to see significant progress towards these recommendations in 2020.

Investors also want **high quality audits** to ensure that the Annual Report and Accounts can be relied upon to make long term investment and engagement decisions. Recent corporate failures have caused investors and regulators to question whether audits are of sufficient quality. This calls for greater disclosure on the audit committee's role in overseeing the auditor and assessing and encouraging audit quality.

Meaningful **stakeholder engagement** is essential to navigating an increasingly complex business environment; helping companies to adapt to the needs of their customers, workforce and the society they operate in. If taken seriously, stakeholder engagement will strengthen the business and promote its long-term success to the benefit of stakeholders and shareholders. The new Director's Duties reporting requirements and the 2018 Corporate Governance Code puts greater emphasis on how directors take employee and other stakeholder interests into account in their decision making. Specifically, the Code asks for companies to follow one of four workforce engagement models. Companies that take stakeholder engagement seriously will be better able to anticipate, identify and respond to the challenges the company faces on a day to day basis. They will be able to take a more holistic approach when setting their strategy and better manage concerns that might otherwise be overlooked.

Meanwhile, **diversity** in listed companies is improving. As the recent Hampton-Alexander Review FTSE Women Leader's report shows, FTSE 350 companies have made significant progress on diversity in 2019. The FTSE 100 is already close to meeting the Hampton-Alexander Review targets of one third female representation on boards by the end of 2020, while the FTSE 250 is on track for the same target. But more progress is needed to ensure that companies are embedding diversity throughout the organisation and nurturing a diverse generation of future leaders. As a central component of good governance, improving diversity will continue to be an investor expectation beyond the Hampton-Alexander Review's 2020 deadline.

Companies will be expected to look beyond 33% representation, make greater efforts to appoint women to senior leadership positions and address structural barriers that limit the development of diverse talent. While gender is a strong indicator of a company's approach to diversity, companies need to look at all aspects of diversity. The target date for companies to meet the Parker Review's target of at least one director from a minority ethnic background on every FTSE 100 board by 2021 is also fast approaching. Investors expect companies to start to make more disclosures on ethnic diversity to inform more progress here.

This document outlines why investor consider these four issues to be important areas of focus for companies this year and also sets out their expectations for change in 2020. For companies with year-ends on or after 31 December 2019, IVIS, the IA's Corporate Governance research service, will assess the progress made and highlight where they are not meeting investor expectations.

This list is not exhaustive. Investors continue to engage with companies on the full range of financial, strategic and other ESG issues in the pursuit of stable, long-term returns for their savers. However, the four issues covered in this document present an opportunity to better the UK's listed market; making it more diverse, future-proof, holistic and resilient.

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RESPONDING TO CLIMATE CHANGE

There is mounting evidence of the significant risk that climate change poses to individuals, companies and financial markets. The risks associated with the impact of climate change could result in a significant loss of value in listed companies. This will ultimately impact on ordinary savers, whose pensions and savings are invested in these companies. These savers are increasingly alert to the risks to their investments and are rightly setting high expectations of how investors are managing their money in response.

Climate related risks to companies range from the impact of extreme weather events on business operations and supply chains to changes in consumer demand. Governments around the world are looking to limit global warming and honour their commitments to the Paris agreement. They are introducing new policies and regulations to reduce greenhouse gas emissions, resulting in further transition risks for the companies responsible for, or reliant on, these emissions for their products and business success. These physical and transition risks also carry significant liability implications for companies.

As long-term investors in listed companies, IA members' ability to create sustainable value on behalf of savers will be significantly affected by how well listed companies manage the impact of climate change. This long-term investment time horizon also means that savers are positioned to benefit significantly from realisation of potential returns if companies and the economy transitions to a more sustainable position.

1. Investor Expectations of Companies

Investors expect listed companies to proactively identify and manage climate related risks and opportunities *and* to make material climate change-related disclosures. These steps are critical for companies to minimise the negative impacts of climate change on their long-term value and to help realise the financial opportunity of a sustainable transition. IA members expect all listed companies to include a discussion in their annual report of the impact that climate change will have on their business and how the company is managing this impact.

Since 2013, all listed companies have been required by law to measure and report on the greenhouse gas emissions they are responsible for through the combustion of fuel and the operation of any of their facilities. This is an important step for enabling investors to assess the carbon intensity of their portfolios and forms part of the picture of the risks investee companies are exposed to from climate change. Emissions disclosures provide some indication of climate related risks but don't inform investors on the approach companies are taking to managing these, or the wider range of climate related risks they are exposed to.

The disclosures made by companies on how they are managing climate change risks help IA members make informed investment decisions and identify where further action is needed to support and challenge companies to transition. Quality disclosures by listed companies will support more accurate asset valuations reflecting exposures to climate risk and thereby contribute to financial stability. They will also support IA members to make accurate reports to their clients and meet their own reporting obligations. We therefore support the recommendation in the UK Government's Green Finance Strategy that all listed companies should disclose in line with the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations by 2022.

Task Force for Climate related Financial Disclosures

The Taskforce for Climate-related Financial Disclosures is a globally recognised reporting framework developed by the Financial Stability Board. It is designed to enable better information on climate related risks and opportunities for better integration of the financial impacts of climate change into the investment process. The disclosure framework consists of guidance for disclosures on four key components on governance, strategy, risk management and metrics and targets.

TCFD reporting by listed companies is an important tool to understand how companies are managing climate related risks. These disclosures should be the result of meaningful action by companies to address the impact of climate change on their business model and strategy.

We recognise that both investors and companies are on a journey to understanding and managing the impact of climate change on their business model and strategy. Investors want to understand the work that is being undertaken to comprehend and manage this impact and reach full disclosure in line with TCFD by 2022. We have set out in more detail the actions investors expect companies to be taking to inform disclosures under each of the TCFD components.

<u>Governance</u>

Investors expect both Executive and Non-Executive Directors to be fully versed on the impacts of climate change on their business. Board members should be informed about how their company is managing this impact and fully prepared to engage with investors on these matters. This is a matter for the whole board - as climate change fundamentally impacts on the company's long-term viability and therefore should inform their long-term strategy.

Boards should be prepared to take their company on a journey to identify the risks they are exposed to and any opportunities associated with a sustainable transition. This assessment should inform their business model and strategy.

Companies should have a governance process in place to manage and oversee their response to climate change with clearly defined responsibilities for oversight and management. While this is a matter for the whole board, the company may also wish to identify additional roles and responsibilities for the audit, nominations and remuneration committees.

<u>Risk Management</u>

Companies should proactively identify which climate related risks they are exposed to, including physical, transition and liability risks and disclose how they manage these risks.

All companies should recognise that the pervasive and complex nature of these risks mean that it is not always immediately apparent which direct or indirect impacts are financially material.

Companies should undertake a systematic assessment which considers impacts on their products and services, operating model, assets and financial position, supply chain, as well as on their key stakeholders, employees and customer base. Companies should set up robust systems and controls to manage these risks including clearly defined responsibilities for monitoring and oversight by the board and management.

Different industries and economic activities will have varying degrees of exposure to climate related risks. Companies that play a larger role in contributing to global warming through high levels of greenhouse gas emissions and those companies that are most exposed to physical, transition and liability risks arising from climate change should act with urgency. For these companies in particular, it is clear that business as usual will lead to business failure.

Strategy

Informed by their risk assessments, investors expect all listed companies to consider how to adapt or strengthen their business model and strategy to ensure long-term viability in response to climate change. For certain industries, this strategy may include pursuing opportunities to contribute to climate change mitigation and adaptation for example through more efficient use of energy and resources, or by developing new products and services.

This strategy should be supported by and linked to the company's approach to capital management including:

- Any relevant capital expenditure on infrastructure and operations to manage physical risks,
- Changes to their business structure, including acquisitions or disposals to transition the business model, and
- Investment in research and development to develop new products and services.

Metrics and Targets and Scenario analysis

Companies should set targets and KPIs aligned with their risk management approach and their plans to transition their business model and strategy.

Companies should consider how resilient their business model is in different scenarios, including under varying degrees of global warming and in the face of different policy responses designed to curtail greenhouse gas emissions. This scenario analysis should inform their approach to governance, risk management and strategy.

2. IA Member Actions

IA members have committed to focus on UK investment managers' response to climate change as one of the Investment Association's priorities for 2020. IA members' support the recommendation in the UK Government's Green Finance Strategy that all listed companies should disclose in line with the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations by 2022. Investors want to understand the work that is being undertaken to comprehend this impact and reach full disclosure in line with TCFD by 2022.

As companies take the journey to TCFD compliance, IA members are scrutinising listed companies approach to and disclosures on climate change. They want to understand the risks of climate change to the business, strategy and product mix and how companies are managing the impact of climate change and, where relevant, adapting their business model and strategy to ensure long-term viability. These disclosures are essential evidence of how well companies are responding to climate change and of leadership from the company's directors and are therefore increasingly being used to inform investment decisions, engagement and voting activities.

FTSE 100

Our analysis of FTSE 100 companies shows that in their most recent annual report:

- 30 companies have made a statement that they have implemented the TCFD recommendations
- 38 companies have described their governance of climate change related risks and opportunities
- 53 companies have described some climate change related risks.

It is clear that some of the very largest companies are beginning to seriously consider the risks associated with climate change, however more work is needed to increase and improve how comprehensive these disclosures are.

IVIS Approach

To support our members engage with companies on climate change, IVIS will introduce a new section to its ESG report, highlighting to investors whether the company has made climate change-related disclosures. This will be informed by four questions, aligned with TCFD.

1. Does the company describe its governance of climate related risks and opportunities?
2. Does the company describe the actual or potential impacts of climate related risks and how it will assess and manage them?
3. Does the company explain how its strategy takes into account the impact of climate change?
4. Does the company describe climate change related metrics and targets?

We recognise that companies are on a journey to fully comprehend the impact of climate change on their long-term viability and how best to communicate their response to investors. To reflect this we will not be introducing any colour top for these disclosures in 2020, but will keep this under review for future years.

AUDIT QUALITY

Investors rely on the financial information presented in a company's annual report and accounts to make informed investment decisions. The quality and robustness of the audits of these accounts are therefore essential to making good investment decisions and to hold management and boards to account.

For investors, a high quality audit is one where the auditor challenged management's judgements and assertions, displayed independence from management and exercised professional scepticism. These behaviours will support robust financial information to inform investment decisions and will crucially help to identify any concerns about the long-term viability of a company.

However, recently trust in audits has been undermined. The high profile failures of companies have raised concerns that auditors may not be providing the desired level of scrutiny or rigour. These corporate failures have had ramifications not only for investors and the savers they invest on behalf on, but also for companies' employees, customers and other key stakeholders.

In 2018, the FRC's Audit Quality Review noted a significant decline in audit quality. This improved in 2019 but still fell short of the standards expected, with the FRC re-iterating that auditors need to improve their challenge of management urgently[1]. The results continue to raise questions as to the value of audits to the investors who rely on them. Given these ongoing concerns with the quality of audits, audit committees have a role in demonstrating how they have assessed the quality of their audit.

Independent Reviews into Audit Reform

Audit reform has been a hot topic in the last year and has been subject to a number of reviews:

1. Sir John Kingman undertook a review of the FRC, following which he recommended the establishment of a new regulator, the Audit, Reporting and Governance Authority, with stronger powers.

2. The Competition and Markets Authority conducted its Statutory Audit Market Study and found a lack of competition in the audit market, ultimately impacting audit quality. The CMA recommended more audit committee scrutiny, mandatory joint audit and peer review, an operational split between the 'Big Four's' audit and non-audit businesses.

3. Sir Donald Brydon's wide-ranging review into the quality and effectiveness of audit called for a "fundamental shift in definition and approach" to make audit more informative, improve the cost and allocation of capital, and increase the quality and effectiveness of audit in the UK.

1. Investor Expectations of Companies

The audited information companies report to the market inform investors' approach to making investment decisions and holding company management and boards to account. Investors expect a well-planned and resourced audit team, capable of providing a quality audit and bringing attention and scrutiny to a company's financial concerns.

Investors expect companies to be active participants in improving audit quality. Audit committees play a vital role in overseeing the auditor, from overseeing the audit tender process and recommending the ongoing appointment of the auditor, through to ensuring the auditor has been challenging in completing the audit. However, investors are concerned that while the best audit committees genuinely act independently of company management, not all committees use the relationship with the auditor to

[1] https://www.frc.org.uk/news/november-2019/auditors-need-to-improve-their-challenge-of-manage

improve reporting. Nor do all committees sufficiently challenge management on their judgements or auditors on the depth of their work and analysis.

Investors welcomed the increased transparency by audit committees following successive revisions of the UK's Corporate Governance Code. But in practice their disclosures on the approach they are taking are often generic; the IA found that committees are failing to provide informative statements on the quality of audit and how it was assessed. To improve this position, audit committee reports need to properly disclose where challenges have been raised, professional scepticism has been applied and how a quality audit has been delivered. Specifically:

- Annually it should assert how it determined that the auditor has provided a quality audit, including the granularity of key accounting issues and how the auditor challenged management's judgement and assertions and exercised professional scepticism.
- Audit committee reports should not merely replicate what has been provided by the auditor but should, where appropriate, show a tension with the auditor's report. The committee should also report on what it itself challenged and the specific areas it asked the auditor to look at and why.
- It is vital that audit committees consider the unique circumstances applicable to the company and the auditor during the year and provide details on how these were factored into the committee's decision. At present these matters are rarely transparent.
- If there has been a tender, the committee should be transparent as to why it recommended a particular auditor and considered that firm would provide a quality audit.

Unless audit committees work independently, sufficiently challenging auditors on the depth of their work and analysis, audit quality will not improve.

2. IA Member Actions

IA members are paying close attention to companies' disclosures on audit quality and are increasingly willing to target votes on individual members of the Audit Committee and the approval of reports and accounts where these are found lacking. Investors are keen to expand the conversation between investors and audit committees to better understand the challenges they face and the barriers to receiving a high quality audit.

IVIS Approach

IVIS will ask two revised questions of companies to encourage a better focus on audit quality in company disclosures:

1. Has the Audit Committee demonstrated how it assessed the quality of the audit, including how the auditor demonstrated professional scepticism and challenged management's assumptions where necessary?
2. Has the Audit Committee demonstrated how it challenged management's judgements and what happened as a result?

STAKEHOLDER ENGAGEMENT AND EMPLOYEE VOICE

The relationship between a company and its key stakeholders (such as its employees, customers, suppliers, and the environment and communities it impacts) is an important determinant of its long-term value. Companies that manage these relationships well, identifying and engaging with their key stakeholders and understanding their impact on communities and the environment, will be able to use this knowledge to build a more robust strategy and make more informed business decisions. A strong stakeholder voice in the boardroom will benefit both stakeholders and shareholders alike. Companies who do not treat their stakeholders appropriately are unlikely to enjoy success in the long term and may suffer reputational damage which will further hinder success.

Since the previous Government's Corporate Governance Reform agenda, the Directors' Duties set out in Section 172 of the Companies Act have received increased focus with new reporting regulations on how directors have met these duties and the new focus on employee voice in the 2018 Corporate Governance Code. In 2020, companies will have to report for the first time on how their directors have taken stakeholder interests into account and explicitly state how the employee voice is reflected in the boardroom.

Section 172

Section 172 of The Companies Act 2006 defines the duties that directors of a company have. Ultimately, directors have a "duty to promote the success of the company for the benefit of its members as a whole".

In promoting the success of the company, the directors are required to have regard to other stakeholders beyond their shareholders, including their employees, suppliers, customers, the community and environment

Under the 2018 Corporate Governance Code, companies must adopt one or a combination of the following workforce engagement methods:

- A director appointed from the workforce,
- A formal workforce advisory panel and
- A designated non-executive director.

Failing this, the board must explain what alternative arrangements are in place and why it considers they are effective.

1. Investor Expectations of Companies

Investors are keen to better understand how directors are fulfilling their duties and taking account of the views of the company's material stakeholders.

In 2017, the Investment Association, alongside The Chartered Governance Institute (ICSA), produced a report on the Stakeholder Voice in Board Decision Making[2] as guidance for companies. This outlined the core principles that:

- The board should identify and disclose their material stakeholders,
- Decide on the most appropriate mechanism to engage with those stakeholders and
- Clearly articulate how their views have both informed and impacted their decision making.

[2] The Stakeholder Voice in Board Decision Making Process – ICSA and the IA

- Finally, the Board should report back to shareholders and stakeholder on the engagement, the views heard and how they have impacted on Board decision making.

Some commentators believe that recent corporate failures have shown that directors have "not paid sufficient attention to the interests of wider stakeholders"[3]. From our engagement with companies, it is clear that the full breadth of stakeholder engagement companies undertake is not always included in a company's annual report. Investors and other interested parties cannot truly appreciate these efforts unless company's adequately disclose their engagements and the impact those engagements have had on board decision making.

FTSE 100

While progress is being made, a Black Sun review[4] of FTSE 100 companies found that more work is needed to further stakeholder engagement disclosures. In 2019:

- 56% of Chair's statement's in the governance report talk about stakeholders (2018: 29%)
- 28% of companies outline their workforce engagement mechanism:
    - 13 companies used a committee or panel
    - 1 company had an employee representative
    - 14 companies had a designated non-executive director

IVIS Approach

Investors expect companies to identify and engage their key stakeholders and factor their interests into the board-decision making process. IVIS will introduce two new questions to the IVIS report:

1. Has the Board identified the Company's material stakeholders and its engagement with them in the year under review?
2. Which of the four options for workforce engagement outlined in the Corporate Governance Code has the company adopted?

[3] BEIS Committee Corporate Governance Report (2017)
[4] The Ecosystem of Authenticity – BlackSun

DIVERSITY

Investors view diversity as a core and critical business issue that boards and leadership teams must address to secure their long-term success.

Diversity is a key ingredient of effective governance. This is not only a matter of fairness; there is a growing body of research[5] indicating that more diverse boards make better long-term decisions, leading to more productive and sustainable businesses[6]. Diversity of gender, ethnicity, sexuality and socio-economic background can contribute to diversity of thought; allowing companies to diagnose problems they may otherwise miss, to challenge received wisdom, solve solutions in an innovative manner, and think beyond the here and now[7].

Companies that fully embrace diversity will be better equipped to foresee and act on risks and opportunities, make better long-term decisions, nurture talent and command the trust of the consumers they serve. These companies will ultimately deliver better long-term returns for investors and savers.

1. Investor Expectations of Companies

Investors expect companies to continue to improve their approach to diversity across their board, senior leadership and throughout the workforce. This should apply to diversity in all its forms. Investors are particularly focused on gender and ethnic diversity as strong indicators of a companies' overall approach.

The IA strongly supports the aims of the Hampton-Alexander Review to have 33% female representation on FTSE 350 boards and senior leadership teams by the end of 2020.

Hampton-Alexander Review

The Hampton-Alexander Review is a Government sponsored independent review dedicated to increasing the number of women on FTSE 350 boards and senior leadership positions. The Review was established in 2016, to progress the work of the Davies Review that began in 2011.

The Review established five recommendations targeted at FTSE Chairs, CEOs, Government, investors and executive search firms, headlined by a target of 33% female board representation in FTSE 350 companies by the end of 2020.

The Review also set a target for FTSE 350 companies to achieve 33% female representation within the company's executive committee and their direct reports by the end of 2020.

The Review captures over 23,000 leadership roles and is arguably the biggest and most ambitious voluntary initiative in this field across the world.

<u>Boards</u>

Welcome progress has been made in recent years on gender diversity on FTSE 350 boards. Investors want companies to continue to make substantial progress towards 33% representation by the end of

[5] The Business Case for Change – International Labour Organization
[6] Does Diversity Pay?: Race, Gender, and the Business Case for Diversity – Cedric Herring
[7] Avoid Groupthink with Diversity of Thought – CreativeHuddle

2020. Boards should be aspiring to achieve over one third female representation as soon as possible so they are better equipped to cope and respond to unexpected events within their Board composition.

Investors are keen that companies do not view the 2020 targets and the end of the Hampton-Alexander Review cycle as an end in itself. They will continue to seek further improvements in diversity beyond the 33% targets and will scrutinise the reappointment of individual nomination committee members, in particular the chair, where there is insufficient progress.

Senior Leadership

While progress on board diversity has been encouraging, there remains significant room for improvement in developing diverse leadership teams. Companies need to go further than looking at gender diversity on their board positions and look carefully at the pipeline of talent that is the bedrock of company's future success.

Improved diversity amongst the executive committee and their direct reports is essential to ensuring that companies are reaping the benefits of diversity throughout the organisation and nurturing a diverse generation of future leaders. A diverse senior leadership team signals to the workforce that there are opportunities for progress within the company, regardless of background, and that diversity is an issue that the company takes seriously. Without this, the ability of a company to recruit and retain its best talent is hampered. Moreover, a diverse senior leadership team can provide more holistic, comprehensive decisions, cognisant of the wide variety of issues that may trouble both the workforce and the company's wider stakeholders. Investors will be looking carefully at companies' approach to succession planning and how this serves to promote diversity.

FTSE 350

In 2019, the Hampton-Alexander Review found that women held:

- 32.4% of FTSE 100 board positions (2018: 30.2%)
- 29.6% of FTSE 250 board positions (2018: 24.9%)
- 28.6% of FTSE 100 senior leadership positions (2018: 27%)
- 27.9% of FTSE 250 senior leadership positions (2018: 27.9%)

This suggests that FTSE 100 companies will meet the target for women on boards by the end of 2020, with the FTSE 250 likely to also meet the target if progress continues at the same pace. However, the Hampton-Alexander finds that half of all available roles will have to go to women if the FTSE 350 is to achieve the senior leadership targets by the end of 2020.

Ethnic Diversity

Investors also expect companies to place a greater emphasis on ethnic diversity. Companies will need to think beyond gender and consider the role of diversity in the round, in particular by making progress on the ethnic diversity of their board and senior leadership teams as outlined by the Parker Review.

The Parker Review

The Parker Review is a government sponsored independent review dedicated to improving the ethnic and cultural diversity of UK boards to better reflect their employee base and the communities they serve. The Review noted that the progress made on gender diversity was not being made on ethnic and cultural diversity.

The Review identified "clear commercial benefits" to improving ethnic diversity and established three recommendations, headlined by the 'one by '21' initiative whereby every FTSE 100 board would be expected to have at least one director from an ethnic minority background by 2021 (with every FTSE 250 board to do the same by 2024). Other recommendations included developing a pipeline of candidates and mentoring schemes, and enhanced transparency and disclosure.

Investors understand the challenges that collecting ethnicity disclosures can pose. Nevertheless, they would like to see companies make efforts to improve their disclosures in 2020 and demonstrate that they are making progress towards the Parker review target of one ethnic minority director on every board by 2021.

2. IA Member Actions

IA members are scrutinising the progress companies are making on diversity and are increasingly using their engagement and voting tools to this end. In March 2019, the IA wrote alongside the Hampton-Alexander Review to 69 companies with only one (or no) women on their board, known as 'one and dones'. By the end of the year, 39 of the companies added at least one additional women to their board.

In 2020, the IA will continue to focus on 'one and dones' and seek to understand how the board intends to meet the Hampton-Alexander review targets by the end of 2020 and any outstanding barriers to achieving greater diversity. The IA will introduce a focus on the level of diversity within the executive committee and their direct reports, writing to companies with the least diverse executive committees.

IVIS Approach

To support members in their engagements on diversity and to support the Hampton-Alexander Review and Parker Review targets, IVIS will take the following approach.

Gender Diversity

FTSE 350

IVIS will red top any company with:

- Women representing 20% or less of the Board
- Where there are one or less women on the Board (unless the one third target is achieved i.e. a board of three directors)
- Women representing 20% or less of the Executive Committees and their direct reports

FTSE SmallCap

IVIS will amber top any company with:

- Women representing 25% or less of the Board
- Where there are one or less women on the Board (unless the one third target is achieved i.e. a board of three directors)
- Women representing 25% or less of the Executive Committees and their direct reports

Ethnic Diversity

IVIS will ask a new question of all companies:

- Has the Company disclosed the percentage of its Board that comes from an ethnic minority background?

Contact Details

For further details on these policy positions or the IA's Public Register please contact Sarah Woodfield (sarah.woodfield@theia.org) or Laith Cahill (laith.cahill@theia.org)

For further details on IVIS, please contact Nicholas Malasinski (Nicholas.malasinski@theia.org)

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theia.org

@InvAssoc