LIGHTHOUSE

DECEMBER 2021 | EMEA EDITION

MORROWSODALI

THE 2021 EUROPEAN AGM SEASON

Discover the new normal resulting from the pandemic and how the focus is firmly on corporate governance

ALSO, IN THIS EDITION:

COP26: Key takeaways for corporates and investors

Group governance: Read our analysis of the corporate governance of subsidiary boards

CONTENTS

FOREWORD

Welcome to the EMEA edition of Lighthouse for 2021. Last year, companies and their leadership were in crisis management mode to weather the COVID spread and adapt to extraordinary circumstances. The most successful companies saw management, boards and shareholders supporting each other, backed by the trust of strong governance. Monitoring and challenge were put in parenthesis for a few months, but definitively resumed in 2021. This year was a transition year. With profound and long-lasting changes, the pandemic has changed the world and accelerated its transformation. Companies and shareholders started to look forward and shape the future rather than just grind through the present. The articles in this edition illustrate how shareholders and boards addressed these temporal imperatives and the forces shaping governance. Governance is a journey, not a destination. Crisis has often been a driver for change. This one is no exception.

20 years ago[1], Enron became (at the time) the largest bankruptcy in American history. Kenneth Lay and Jeffrey Skilling had unwittingly opened the door to a dramatic shift in corporate governance, recalibrating the balance of powers from the executive suite to the boardroom. Since, boards have become the cornerstone of sound governance, expected by regulators and shareholders to play a prime role in approving strategy, monitoring its implementation, and ensuring accountability. Directors have since been expected, inter alia, to work harder, be available, cultivate independence of mind, be knowledgeable, be engaged and constructive.

2021 marks another anniversary. Also 20 years ago, the Myners Report[2] condemned the lack of engagement of money managers. This report inspired the Institutional Shareholders Committee (ISC) to issue a guidance endorsing shareholder activism. About a decade after, the UK FRC published the first "Stewardship Code", promoting responsible allocation, management, and oversight of capital to create long-term value. Since, companies face increasingly concentrated institutional investors, increasingly focused on environmental and social (E&S) issues. Passive funds surpassed actively managed funds' aggregate assets under management for the first time in history a couple of years ago. The majority of investors now see that divesting from certain environmental, social and governance risks is no longer possible in standard index vehicles. E&S has become a proxy for good risk management and long-termism, two chief concerns today.

Hence, companies are adjusting to a new paradigm shift, from a shareholder-centric age to a stakeholder era (back to the future). Beyond the debates accompanying these rebalancing forces[3], the fact is that now 4,375 organizations and investors, representing US$121 trillion of AUM are signatories of the Principles for Responsible Investment[4].

Corporate governance changes are faster and bolder (I would invite you to also read the "Evolution of corporate governance"[5]) but the fundamental principles of good governance remain. This new paradigm simply reinforces them. Fairness, accountability, responsibility, and transparency were at the heart of governance discussions this year and will remain.

In relation to accountability, shareholders increased their scrutiny and engagement. Our advisory mandates reflect that. The articles in this edition show that overall institutional participation was unimpeded by COVID. AGMs are and will remain an important time to hold directors and management accountable for their performance. Hence the concern expressed by 9 out of 10 institutional shareholders[6] that virtual meetings could allow management to unreasonably curate questions and limit the Q&A opportunities.

On responsibilities, boards are more than ever expected to ensure company resilience and lasting success. We witnessed first-hand that many boards worked harder

1. Enron filed for bankruptcy in November 2001
2. Available at https://webarchive.nationalarchives.gov.uk/ukgwa/20010603090552/http://www.hm-treasury.gov.uk:80/pdf/2001/myners_report.pdf
3. Bebchuk, Lucian A. and Tallarita, Roberto, The Illusory Promise of Stakeholder Governance (February 26, 2020). Cornell Law Review, Volume 106, 2020, pp. 91-178, Harvard Law School John M. Olin Center Discussion Paper No.1052, Harvard Law School Program on Corporate Governance Working Paper 2020-1, Available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978
4. PRI Q4 2021 Update, https://www.unpri.org/signatories/signatory-resources/quarterly-signatory-update
5. https://morrowsodali.com/insights/the-evolution-of-corporate-governance
6. https://morrowsodali.com/insights/evolving-stakeholder-expectations-on-climate-disclosures-and-governance-iss-2021-global-policy-survey

to ensure the company they lead is organizationally and strategically adapting to a new environment where volatility, digitalization, development of talents, and sustainability are becoming the "new normal". Boards are recalibrating their agenda and modus operandi to keep a long view and not be trapped in the operations like many were in 2020. Shareholders do expect boards to be strategic and effective. Discussions around Say on Climate, with very distinct levels of shareholder support for board proposals versus shareholder proposals clearly illustrate that.

Transparency, and beyond it, the ability to navigate through data and convey the right messages are important challenges for boards and shareholders. In that respect, back from Glasgow, Elena Cargnello, Corporate Director of Marketing, presents in this edition the COP26 takeaways and discusses the importance for companies and shareholders of the newly set-up International Sustainability Standards Board. In a separate article[7], Morrow Sodali's Strategic Board Advisor Maryann Waryja discusses the evolving trends in ESG disclosures. Her interview complements well the articles in this edition.

We hope this issue of Lighthouse will provide helpful insights ahead of the coming year.

David Risser
Managing Director
Nestor Advisors

7. https://morrowsodali.com/insights/morrow-sodali-leadership-series-evolving-trends-in-esg-disclosure-morrow-sodali-q-a-with-maryann-waryjas

COP26 TAKEAWAYS: WHY COP26 MATTERS? WHAT HAPPENS NEXT?

PERSPECTIVES FOR CORPORATES AND INVESTORS

In this article, Elena Cargnello, Morrow Sodali's delegate to the UN Climate Change Conference in Glasgow, looks ahead to the outcomes of the conference and shares some insights from the ground. Beyond the negotiations, we reflect on what the agreement taken means for the business community and how Morrow Sodali can help reframe the outcomes into business action and impact.

Last month, leaders of 120 countries met in Glasgow for the **United Nations (UN) Climate Change Conference of the Parties (COP26)** to finalize the rules governing the implementation of the Paris Agreement, adopted at COP21 in 2015, under the **UN Framework Convention on Climate Change.**

The enhanced ambition to tackle the climate crisis, namely to limit warming to 1.5°C by reducing global emissions by **45%** by 2030, has resulted in a revised deal after marathon negotiations and last-minute changes to the text of the agreement, as requested by China and India. The two nations specifically pushed for the language on coal to change from "phase out" to "phase down".

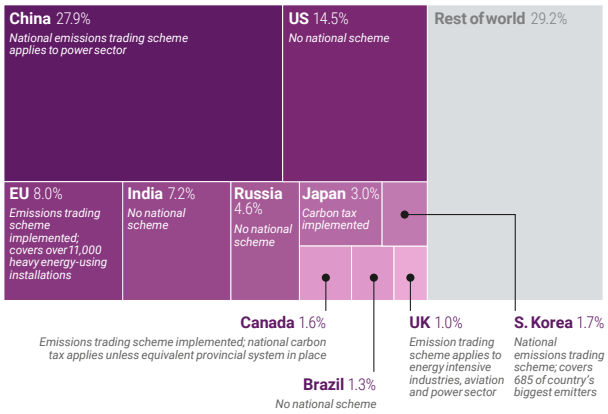
Separately, China and the US released a generic joint statement announcing how the two largest emitters[1] intend to boost climate cooperation over the next decade.,

Meanwhile, the Glasgow summit launched a key initiative and commitment that may represent a game-changer in company reporting to address the need of transparency and standardized frameworks at a global level. In this regard, the **IFRS Foundation** has announced the establishment of a new **International Sustainability Standards Board (ISSB)** aimed at developing comprehensive global baseline sustainability reporting standards to meet investors' information needs and better assess the value of companies[2].

In an effort to consolidate the leading investor-focused sustainability disclosure organizations into the ISSB, this new international sustainability reporting framework will draw on the technical standards and frameworks of the **Climate Disclosure Standards Board** (CDSB), and the **Value Reporting Foundation** (VRF - which houses the **Integrated Reporting Framework** and the **SASB Standards**).

The Foundation also published two prototype standards to enable the ISSB to rapidly build on existing frameworks. These include the Financial Stability Board's **Task Force on Climate-Related Financial Disclosures** (TCFD) and the World Economic Forum's **Stakeholder Capitalism Metrics**, that will form the basis when developing its standards.

Top ten carbon emitters' share of global emissions, and details about their national carbon pricing schemes



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Source: World Bank, Our World in Data, ICAP

GZERO

1. For reference about the top ten carbon emitters' share of global emissions, see the graphic GZERO, 22 October, 2021, https://www.gzeromedia.com/search/?q=global+emitter
2. IFRS, News, 3 November 2021, IFRS - IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements

As a matter of fact, the current fragmentation of reporting frameworks has increased cost and complexity for investors, companies and regulators. The significant demand for high-quality information by investors and other providers of capital requires companies to produce reliable public reporting. Standardized sustainability disclosure frameworks can facilitate a level playing field, while financial markets need to assess the risks and opportunities facing individual companies which arise from environmental, social and governance (ESG) issues, as these affect enterprise value.

Key agreed actions also include improving the ESG ratings market and equipping corporate boards with the tools to effectively drive corporate strategy; developing a policy approach on competence greenwashing; and enhancing corporate governance and the alignment of incentives – including remuneration – in regulated firms by promoting global consistency and comparability in corporate reporting both through international and domestic channels.

Some countries have already started implementing mandatory disclosures associated with climate risk management.

As shown in the table below[3], several countries have already committed to implement the TCFD-aligned requirements, including the European Union, Hong Kong, New Zealand, Singapore, Switzerland, Brazil and the United Kingdom, with Canada and the United States also considering their implementation. Given that the implementation differs across countries through a range of regulatory instruments including supervisory expectations, regulatory action and legislative measures, it is essential to monitor how each jurisdiction will implement mandatory climate risk disclosure. For example, in April 2021, the European Commission adopted a package of measures as part of its policy to help direct capital towards sustainable initiatives[4].

The package of measures includes:

- The **EU Taxonomy Climate Delegated Act** which aims to support sustainable investment by making it clearer which economic activities most contribute to meeting the EU's environmental objectives, i.e. climate change mitigation and adaptation.

- A proposed **Corporate Sustainability Reporting Directive** (**CSRD**), amending the existing reporting requirements under the Non-Financial Reporting Directive (NFRD), which seeks to ensure that companies provide consistent and comparable sustainability information.

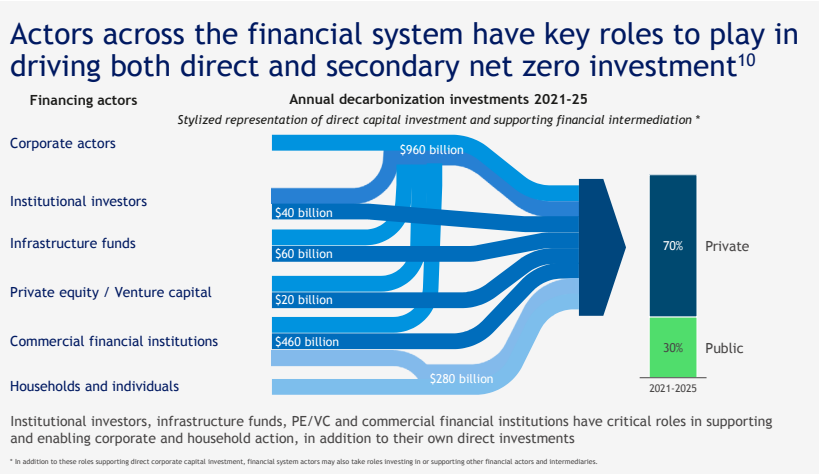
- Finally, **six amending Delegated Acts** on fiduciary duties, investment, and insurance advice, which aim to ensure that financial firms (e.g., advisors, asset managers, or insurers) include sustainability in their procedures and investment advice to clients.

REGION	COVERAGE	REGULATORY INSTRUMENT	MANDATORY	PHASE
New Zealand	Companies, Finance	Legislative	In part, with comply or explain function	Commence 2023
UK	Companies, Finance	Combination	Yes and in part	Committed; increased coverage over period 2021 to 2025
Hong Kong	Companies, Finance	Supervisory expectation and regulatory action	Yes	Committed, and no later than 2025
EU	Companies, Finance	Regulatory	Yes	Committed
Switzerland	Companies, Finance	Legislative	Yes	Committed
Canada	Companies, Finance	Recommended	Under consideration	Considering
Singapore	Companies, Finance	Combination	Yes	Expectation Implemented, Committed
Brazil	Finance	Regulatory	Yes	Committed
US	Companies, Finance	Executive Order	Under consideration (likely)	Considering (likely)

Source: Confusion to Clarity: A plan for mandatory TCFD-aligned disclosure in Australia, June 2021

3. Confusion to Clarity: A plan for mandatory TCFD-aligned disclosure in Australia, June 2021, ConfusiontoClarity_APlanforMandatoryTCFDalignedDisclosureinAus.pdf (igcc.org.au)
4. European Commission, Sustainable finance package, 21 April 2021, Sustainable finance package | European Commission (europa.eu)

The UK has recently announced that from 6 April 2022[5], over 1,300 of the largest UK-registered companies and financial institutions will have to disclose climate-related financial information on a mandatory basis. The required disclosures are in line with the four overarching pillars of the recommendations of the TCFD[6], being governance, strategy, risk management, and metrics & targets.



The new legislation follows the publication of the UK's landmark Net Zero Strategy[7] and forms part of the government's commitment to making the UK financial system the greenest in the world. The new requirements are likely to have particular implications for many of the UK's largest traded companies, banks and insurers, private companies with over 500 employees and £500 million in turnover, as well as for UK public companies listed outside the UK (particularly on the NYSE or NASDAQ) or on AIM, large UK subsidiaries of multinational corporate groups and large portfolio companies of financial sponsors that have a UK topco structure, where the new rules may require them to grapple with climate-related financial reporting for the first time[8].

Discussion around climate finance was also a critical point of contention among developed and developing countries at COP26, where the latter were seeking adequate financial resources to reduce emissions and support sustainable development.

On "Finance Day" at COP26, Mark Carney, former Governor of the Bank of England, announced that the **Glasgow Financial Alliance for Net Zero** (GFANZ)[9] —launched in April 2021 at the Leaders' Summit on Climate Change in partnership with the UNFCCC **Climate Action Champions** and **Race to Zero**, and the COP26 Presidency — can pull together US$130 trillion to be deployed between now and 2050.

The combination of vision, ambition and financial means can be a very powerful force, considering that GFANZ — co-chaired by Mark Carney and Michael R. Bloomberg, with Mary Schapiro as vice-chair — now includes 450 institutions with US$130 trillion AUM who are committed to supporting the transition to net-zero[11].

Although the aforementioned US$130 trillion climate pledge is aimed at putting climate at the heart of finance, some criticism around this bold figure has been raised due to it being extremely large, i.e. six times larger than the annual US GPD. It is important to note that this climate pledge is not an investment fund (as some observers wrongly assumed), but rather the total assets managed by GFANZ's member financial institutions.

In conclusion, the tangible efforts to define an effective level playing field for corporates represents a clearly articulated goal in the battle to halt global warming. On the other side, mamoth financial resources to sustain the carbon transition are required to achieve these efforts, and this cannot be possible without considerable state intervention and investment.

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Adj. Prof. University of London (UoL),
London School of Economics and Political Science (LSE)

5. GOV.UK, Press Release, 29 October 2021, https://www.gov.uk/government/news/uk-to-enshrine-mandatory-climate-disclosures-for-largest-companies-in-law
6. TCFD Recommendations, https://www.fsb-tcfd.org/recommendations/
7. GOV.UK - Department for Business, Energy & Industrial Strategy, Policy paper overview: Net Zero Strategy: Build Back Greener, 19 October 2021, https://www.gov.uk/government/publications/net-zero-strategy
8. Cleary M&A and Corporate Governance Watch, 16 November 2021, https://www.clearymawatch.com/2021/11/uk-introduces-mandatory-climate-related-financial-reporting-for-large-public-and-private-companies/
9. The Glasgow Financial Alliance for Net Zero (GFANZ) is a global coalition of leading financial institutions in the UN's Race to Zero that is committed to accelerating and mainstreaming the decarbonization of the world economy and reaching net-zero emissions by 2050. It provides a practitioner-led forum for financial firms to collaborate on substantive, crosscutting issues that will accelerate the alignment of financing activities with net-zero and support efforts by all companies, organisations, and countries to achieve the goals of the 2015 Paris Agreement. To ensure credibility and consistency, access to GFANZ is grounded in the UN's Race to Zero campaign, and entry requirements are tailored to the activities of the diverse firms represented. Further details can be found on https://www.gfanzero.com/
10. UNFCCC Race to Zero campaign, Net Zero Financing Roadmaps – Key messages, GFANZ, November 2021, https://assets.bbhub.io/company/sites/63/2021/10/NZFRs-Key-Messages.pdf
11. GFANZ (2021), 'Amount of finance committed to achieving 1.5°C now at scale needed to deliver the transition', Glasgow Financial Alliance for Net Zero, 2 November 2021, https://www.gfanzero.com/press/amount-of-finance-committed-to-achieving-1-5c-now-at-scale-needed-to-deliver-the-transition/

2021 EUROPEAN AGM SEASON REVIEW

EXECUTIVE SUMMARY

The 2021 proxy season was the first season after the unprecedented COVID crisis in 2020. A moment where, while most of the consequences of the pandemic still reverberated, the new measures to incorporate the new normal were put in place. In other words, the 2021 proxy season has been a transitional season where both the echoes of the pandemic and the rebirth of corporate governance under a new focus have coexisted.

This publication aims to examine how corporate governance developed during the European proxy season by analyzing three main topics of discussion (shareholder participation, board issues, and remuneration items) across eight European markets (France, Germany, Greece, Italy, Portugal, Spain, Switzerland, and United Kingdom).

In addition, we have performed an in-depth analysis of group governance practice focusing on the coordination and quality of corporate governance in the board of directors of subsidiary companies.

PROXY SEASON PARTICIPATION

Shareholder participation has always been a major concern in proxy season and it became the central matter after the onset of the pandemic. Considering the existing restrictions to movement, is there a legal basis to allow shareholders' meetings to be held only by virtual means? Will the quorum resent this disruption? How does the free float participate?

In general, the current regulatory framework that has been put in place seems to have successfully replaced the previous temporary legal measures passed by the different states in 2020. Although the landscape varies: while some regulations allow issuers to hold virtual-only meetings, some others mandate that remote attendance needs to be from a designated representative.

Regarding the participation, on average it did not negatively reflect the new circumstances. In broad terms, overall quorum and free float participation remained constant with small up and down fluctuations, which proves that issuers, investors and shareholders adjusted well to the new voting landscape.

BOARD

Board elections concentrate shareholders' attention on the companies' financial and non-financial performances, the composition of the boards, and its strategic evolution, however, this season also considered a new particularity: the management of the pandemic by the issuers' governing bodies.

While there have been inconsistent fluctuations in average support to board elections across markets, overall support remained stable. These variations depend on matters such as the gender distribution of the nominees or the types of director classification of the candidates. Nonetheless, the 2021 proxy season confirmed a trend that has repeated over the last few years if we take a closer look beyond the average figures: board controversies trigger a significant toll in terms of shareholder support to the detriment of board nominees.

REMUNERATION

Remuneration is the third pillar in terms of importance in proxy seasons' agendas. In general terms, shareholders seem to keep seeing remuneration-related items as the ideal target to show their discontent. In almost all European markets, shareholder support has dropped or remained unchanged in average terms and at times, shareholders have backed these items below 90% – significantly below the level of support received by board-related items.

Indeed, a number of remuneration reports have failed to pass across several European markets, which often related to poor disclosure and the disconnection between executive pay levels and the performance of the company in the context of a global crisis.

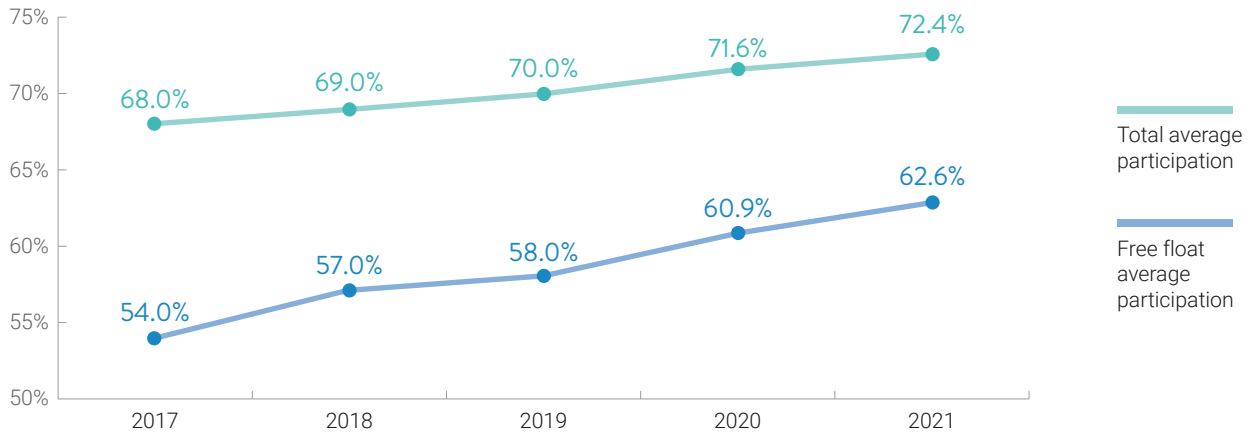
OTHER PECULIARITIES

Finally, some of the articles explain certain specificities that illustrate the differences amongst proxy seasons in the different markets. Aspects such as the proliferation of benefit companies, sustainable purposes in corporations, the growth of Say on Climate items, or the issues surrounding capital requests will demonstrate such market peculiarities.

FRANCE

GENERAL MEETINGS UNDER COVID REGULATIONS

QUORUM - CAC 40 AND NEXT 20



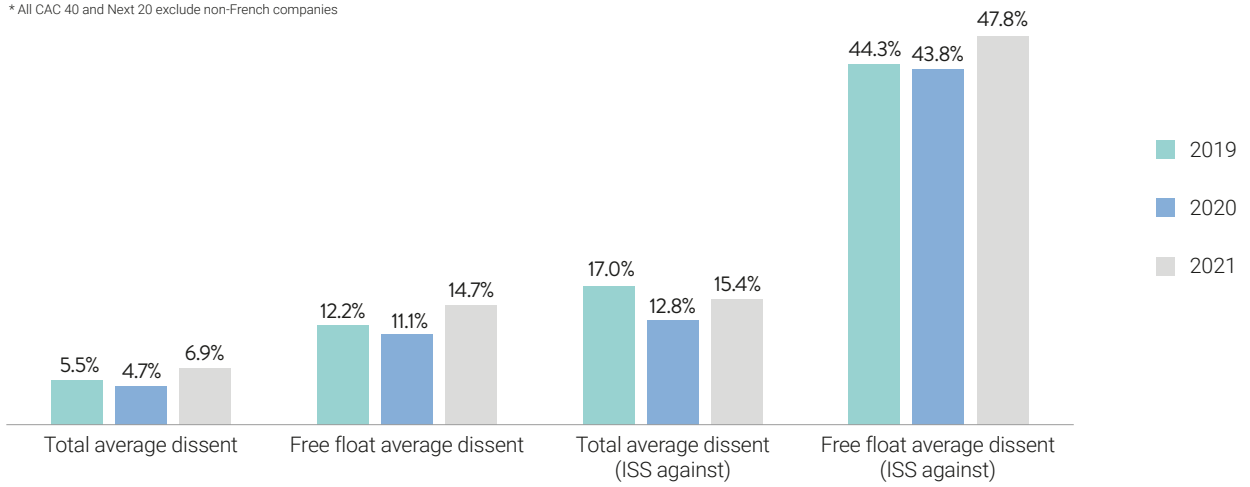
Within the SBF 120[1], **one company** proposed a live vote during the virtual AGM. This could open a gate to hybrid meetings in the future. However, few issuers seem to be ready for the 2022 season.

During the 2021 AGM season, the average quorum continued to increase, reaching **72.4%** of the CAC 40 and Next 20 French companies, and **62.6%** of the free float investors voting in the same universe. This is a long-term trend that we can explain by the investors being better organized to vote and the weight of large investors. MiFID II has also made online voting easier. The French platform VOTACCESS is now available in several French private/online banks and some banks are sending General Meeting alerts to their clients. Finally, virtual meetings have helped companies to not lose the votes of non-attending shareholders.

BOARD

DIRECTORS ELECTION WITHIN THE CAC 40 AND NEXT 20*

* All CAC 40 and Next 20 exclude non-French companies



1. The non-French companies have been excluded of the SBF 120 and CAC 40 Index

46% female representation within supervisory boards of the CAC 40.

More than four years after the Copé-Zimmermann Law deadline which required certain companies to have at least a **40%** representation of women on their boards, the French issuers have almost achieved parity with **46%**.

However, there are only 12 female CEOs within the SBF 120 index and one female CEO in the CAC 40.

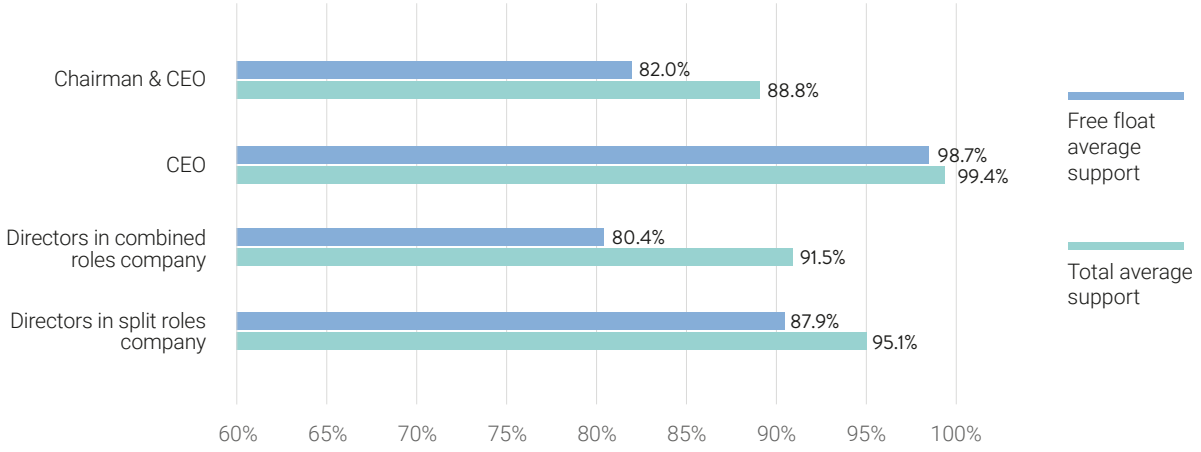
2020 had been a respite season for issuers where the average dissident free float was only **11.1%** of the capital, however, this rate rose to **14.7%** in 2021. Investors mainly voted against the election of directors for the following reasons:

- Lack of independence at the board
- Overboarding of the nominees
- Participation in committees. The three main committees have been targeted in different situations (Audit, Remuneration and Nomination).

It is likely that, in the future, investors will make board members accountable for the lack of female representation within the management board. However, it has not yet been a catalyst to vote against any board members.

In France, combining the roles of chair and CEO is becoming less common. Three companies of the CAC 40 have joined the club of the "split-roles". Some companies are likely to recombine these roles when the chair leaves the company. However, PDGs (Président Directeur Générale) accounted for **63%** of top CAC 40 and Next 20 French companies in 2017, and in 2021 they only represented **43%** of the same universe. It seems that in the long term, only controlled companies, mainly by family, will be able to nominate a new CEO who will be also chair. This is probably the most significant change coming from the institutional investors. In France, PDG was a synonym of CEO and until recently the general population ignored that this role could be split.

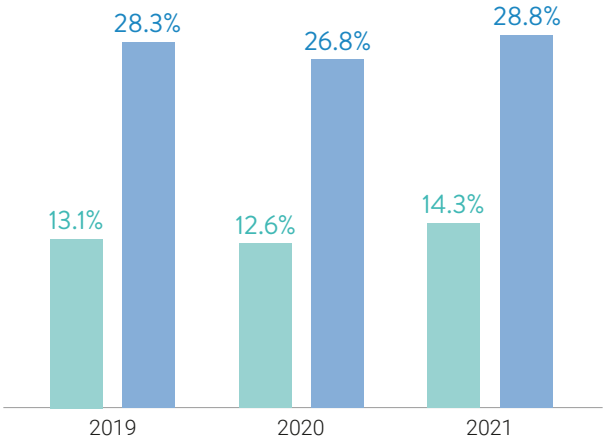
DIRECTORS ELECTION APPROVAL WITHIN CAC 40 AND NEXT 20



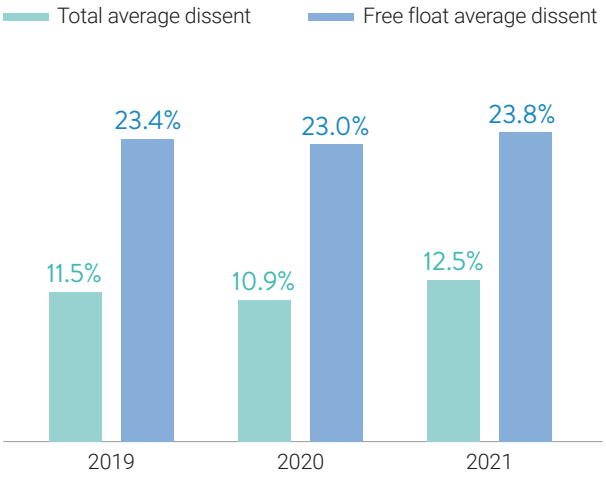
The average free float approval was **99%** for CEO only and **82%** for chair and CEO combined roles. The non-executive directors are also affected with **80%** of free float approval for combined role companies and **87%** for split roles companies.

REMUNERATION

REMUNERATION POLICY (EX-ANTE) DISSENT - CAC 40



SAY ON PAY (EX-POST) DISSENT - CAC 40



Executive remuneration remains a high-profile topic. The average level of free float support is below **80%** (**71%** for remuneration policies and **76%** for Say on Pay). In the COVID context in 2020, investors have been more flexible on remuneration topics. At the 2021 season, they were very concerned regarding the discretionary powers of the boards of companies which adapted their voting policies due to the COVID crisis. The dissenting votes were also due to:

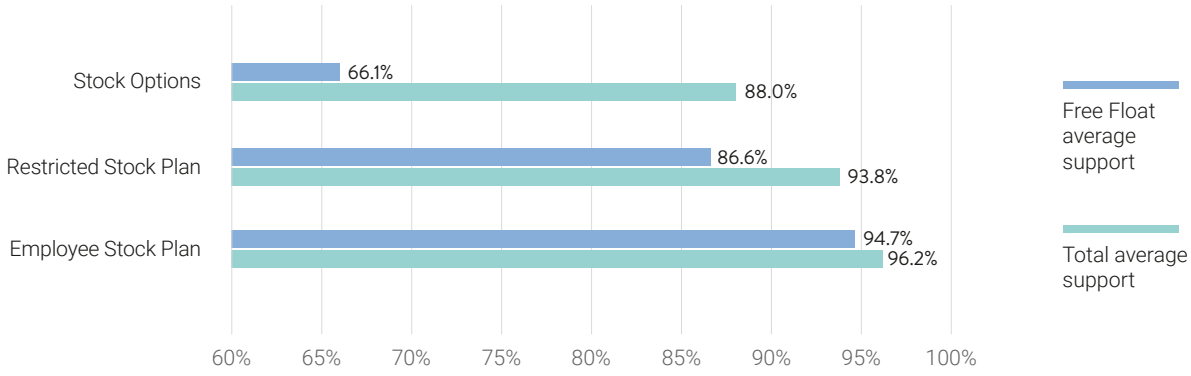
- Departure terms (severance payments, non-compete agreements or retirement conditions),
- increase or excessive amount,
- lack of disclosure,
- stringent criteria.

Each one could be a reason for an against vote or recommendation.

Six french companies in the CAC 40 did not raise any concerns from ISS (vote in favor without flag) and Glass Lewis at both their remuneration policy and Say on Pay.

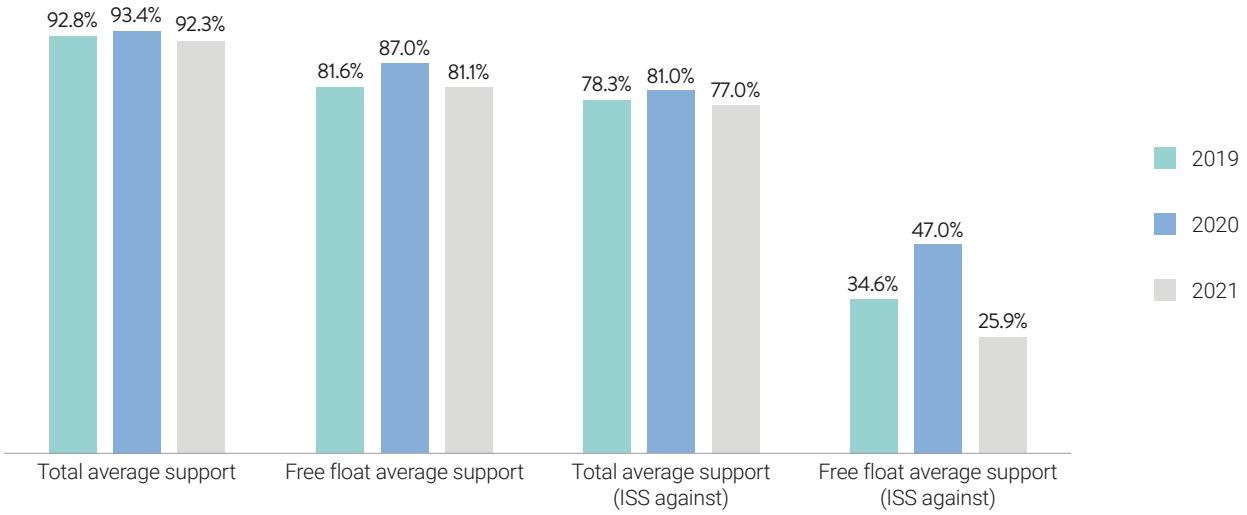
The average free float approval was **87%** for these two resolutions.

EQUITY PLANS WITHIN CAC 40



Only four companies of the CAC 40 submitted stock options to their shareholders for approval. They submitted 24 restricted stock plans and 28 employee stock plans. The dissenting votes on the stock options (**33%** of the free float) were not linked to the nature of these grants but on the disclosure of the performance conditions, vesting period and performance period. They were similar reasons to when the investors voted against the restricted stock plans (**13%** of the free float). On the other hand, the employee stock plans were greatly supported by the shareholders (only **5%** dissent within the free float) even when the main controlling shareholder voted against. Except, all the French issuers are far from a **10%** employee holding which is the maximum allowed by proxy advisors and investors policies and which could ensue a negative vote.

CAPITAL AUTHORIZATION - CAC 40 AND NEXT 20 FRENCH ISSUERS



Shares issuances resolutions received a high rate of approval (**92%** of votes in favor and **81%** of the free float). Except for a few investors which have specific policies on dilution or on specific topics, such as AFG (Association Française de la Gestion - professional body representing the asset management industry) on private placements, they are not contentious. However, these resolutions must respect the general consensus:

- all the authorization to issue rights without pre-emptive rights have to be capped at **10%** and;
- they can't be used during a takeover period.

When ISS recommends voting against such resolutions, usually because companies do not meet these requirements, the free float approval falls to **26%**. Only controlled companies submitted resolutions which received negative recommendations from the proxy advisors and therefore dissenting votes from investors.

CLIMATE RESOLUTIONS

Although only three resolutions have been submitted to the shareholders for approval during the 2021 AGM season, the Say on Climate resolution draws the most attention from the financial community. At the 2020 AGMs, TotalEnergies faced a shareholder resolution which was supported by only **16%** of the free float.

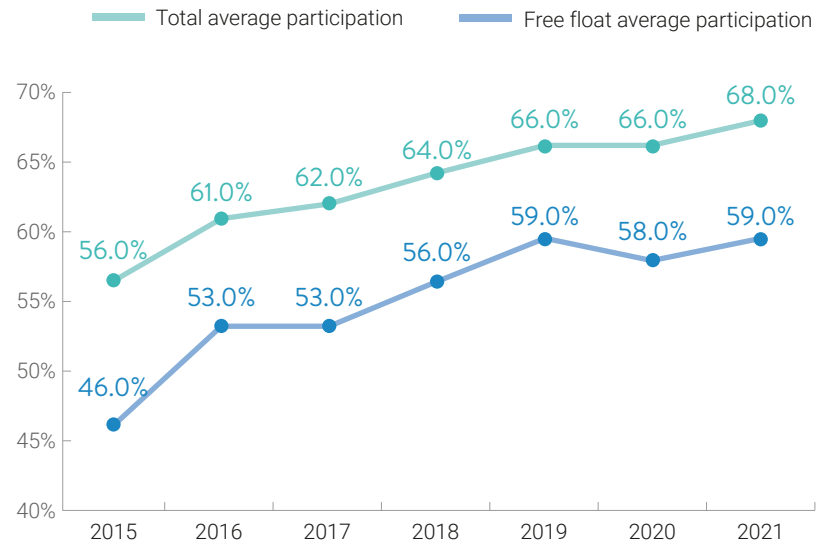
At the 2021 AGMs, three companies (Atos, TotalEnergies and Vinci) submitted a climate-related resolution with an average support of **96%**. ISS supported them but flagged the resolution as the companies did not plan to resubmit an updated report.

GERMANY

GENERAL MEETINGS UNDER COVID REGULATIONS

As was already indicated by the results of the 2020 AGM season, neither the COVID pandemic nor SRD II implementation had a notable negative impact on general meeting participation. Overall levels remained stable, with free float participation even increasing slightly to just above 2019 levels.

QUORUM - DAX



Beyond the mere vote submission via proxy, however, investors emphasised their dissatisfaction with the current COVID-related restrictions on other general meeting related shareholder rights. The general meeting as a physical event carries particular significance in Germany, where often many hundreds, sometimes thousands, of participants attend in person. Two shareholder proposals – a rarity in the German market – were submitted at DAX issuers' general meetings, asking companies to allow questions during the general meeting (with the expectation of an answer). Although both failed, they would have reached comfortable majorities if only free float investors would have voted. All proxy advisors had supported the items. Key ingredients investors are missing during general meetings under the current regulatory regime include:

- The possibility to ask questions and receive an answer.
- The option for shareholders to comment.
- The ability to vote or change already submitted vote intentions.

Two shareholder proposals related to general meeting conduct were submitted in 2021 and widely supported among free float investors.

Although some shareholders may reassess their universal rejection of virtual-only general meetings following the COVID experience, as is also indicated in this year's ISS benchmark policy consultation[1], companies who want to explore this option further should keep in mind that live interaction between shareholders and the company will have to be ensured for shareholders to support related article amendments.

Recent Spanish legislation on virtual-only general meetings, which has been widely supported by investors and proxy advisors, may serve as an interesting blueprint.

1. https://www.surveymonkey.com/r/ISS_2021_Primary_Benchmark_Survey

BOARD

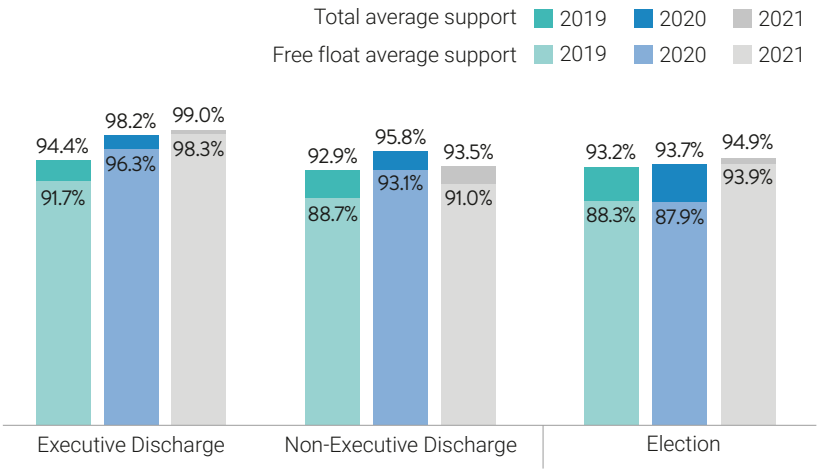
Board elections were overall uncontroversial with average support of free float investors recovering to over **90%**. To some degree, this reflects almost all DAX companies reducing their supervisory board term length to four years or less following recent investor pressure. German market practice is now more aligned with international expectations.

85% of DAX issuers with supervisory board elections in 2021, 17 (out of 20) have insufficient disclosure on how the supervisory board, with particular emphasis on independent directors, oversee environmental and social strategy and implementation based on Glass Lewis (GL) requirements from 2022 onwards.

Although German issuers have remained largely unaffected by the global trend of shareholder motions on environmental and social topics, investors will not only look for more comprehensive disclosure on the governance of E&S and the supervisory board's role therein – they will also expect non-executive board members to talk to them during regular engagement with the supervisory board.

Especially chair elections and discharge proposals may otherwise be affected going forward.

BOARD OF DIRECTORS - DAX



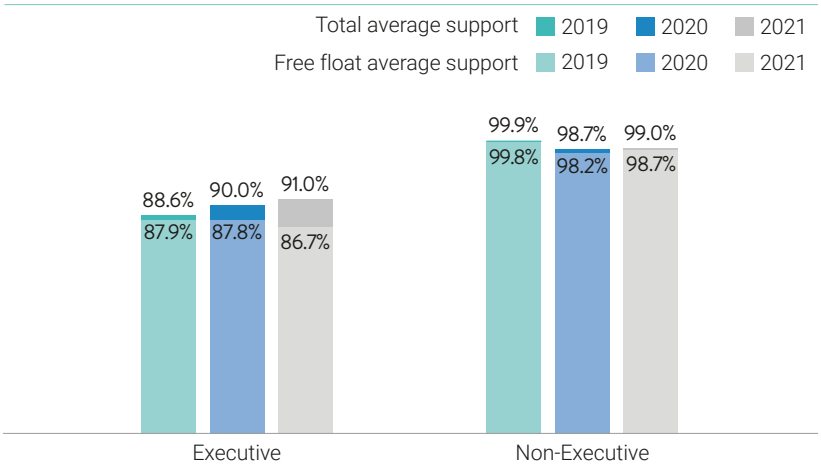
However, there were only 74 election proposals at the 2021 general meetings compared to 97 in the last "election year" of 2019. In the absence of elections at many issuers, some shareholders expressed their concerns with boards by voting against supervisory board discharge proposals instead. Where previously withholding discharge corresponded to governance failings resulting in material repercussions for the company and its shareholders, investors are now increasingly applying the same logic to election items: if they would not have voted in support of the election of all board members, they would not vote for the discharge of the supervisory board. This behavior is also reflected in the statistics: although the average free float support remains comfortably above **90%**, 11 DAX issuers would have had less than **90%** support if only free float investors had voted in 2021. In 2019, there were seven negative ISS and nine negative GL recommendations, compared to two negative recommendations by each of the proxy advisors in 2021. There was record-low average support for supervisory board discharge proposals in 2019—only eight companies. Thereby the major issues in 2021 have not materially changed. They have just been extended to discharge resolutions, which now include:

- Independence, with additional concern for the independence of key committees and board roles.
- Overboarding, also considering the type of external mandates a director may hold and often beyond proxy advisor guidelines.
- Accountability for historic decisions, including external mandates.

REMUNERATION

With 50 management proposals compared to 19 in 2020, 2021 was a record year in terms of the number of remuneration-related voting items. As one of the last countries to fully implement SRD II, DAX proposals were largely limited to forward-looking policies with only one advisory vote on remuneration reporting for FY2020.[2]

REMUNERATION - DAX



Supervisory board remuneration remains unproblematic. Average support of management remuneration is increased as well. However, the average approval if only free float investors fell for the second consecutive year – despite generally positive proxy advisor recommendations. ISS recommended against two items (**8%** of all executive remuneration proposals), up from none in 2020, but still noticeable below pre-SRD II levels of **17%** (2019) and **38%** (2018). GL was more sensitive, with four against recommendations (**15%**), up from only one (**9%**) in 2020. Where ISS was focussed on the application of discretion and the availability of entire discretionary bonus options which have been terminated by most DAX companies, GL took a closer look at disclosure levels around potential variable pay metrics. Similarly, in instances of low free float support, investor critique centered around performance measurement and investor alignment:

- Transparent criteria potentially leading to special bonuses.
- High-level descriptions of variable performance metrics without specifying performance criteria, including the determination of bonus multipliers.
- Too few or only fixed performance criteria measuring long-term performance.
- Lack of shareholding guidelines or awards in equity and further deferral.

One DAX issuer proposed a remuneration report item in 2021.

In their remuneration policy analyses, proxy advisors and investors made clear that the current level of disclosure on performance metrics of German companies may not suffice to support the remuneration reports in 2022.

Targets and target achievement will come under additional scrutiny.

German issuers may be better advised to review EU and UK peers' disclosures rather than domestic market practice to prepare for full SRD II implementation in 2022.

"2021 was a record year in terms of the number of remuneration-related voting items"

2. Only Linde proposed additional remuneration items due to their incorporation in Ireland and US listing.

GREECE

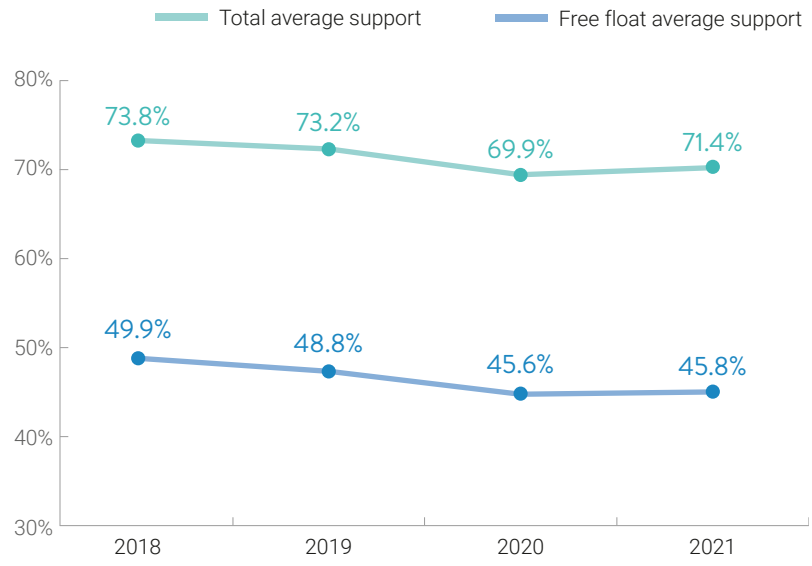
GENERAL MEETINGS UNDER COVID REGULATIONS

As indicated in the graph below, total and free float participation both saw a significant drop of over **4%** in 2020 compared to 2018. This was most likely the result of COVID-related affects on technical vote submission processes and the lack of technical expertise and preparation for complete virtual meetings. In the 2021 proxy season, attendance at general meetings slightly increased but did not reach the pre-COVID levels of attendance. Total participation increased by **1.5%** and free float participation increased by **0.2%**. The AGMs conducted during 2021 allowed for digital and hybrid attendance, thus granting more flexibility for attendees. This indicated that Greek companies took action to facilitate and enable remote AGM attendance following the COVID crisis. However, the discrepancy between 2019 (pre-COVID) and 2021 (post-COVID) attendance still indicates an approximate two (total) and three (free float) percentage point decrease.

Recent changes in Greek Corporate Law formed the basis for the **2021 Corporate Governance Code for Listed Companies** ("the Code") that replaced the previously applicable 2013 CG Code.

Nestor Advisors, a Morrow Sodali company, assisted the Hellenic Corporate Governance Council with the revision of the Code and provided their input and feedback on its content and structure based on their expertise on corporate governance and extensive experience in developing corporate governance codes, including the first Hellenic CG Code in 2013.

QUORUM - ATHEX 25



This is in line with previous information relating to Greek shareholders' attendance at AGMs especially considering the low rates of free float participation—less than **50%** in the last four years. According to the 2020 findings, the low participation in the ATHEX 25 AGMs was largely driven by the low free float participation rate (**45.6%**). Similar to the 2020 findings free float participation continues to drive the low 2021 total participation rate since the observed increase did not exceed **0.2%** for 2021. In examining the reasons behind the low rates and small increases, the effect of COVID on the AGM processes must not be ignored.

"In the 2021 proxy season, attendance at general meetings slightly increased but did not reach the pre-COVID levels of attendance."

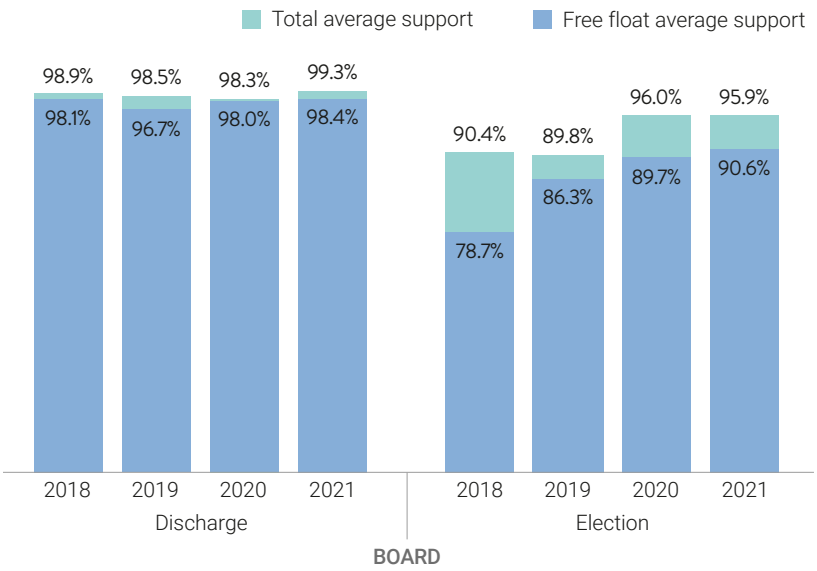
BOARD

During 2018 and 2019, Greece saw an improvement in board elections and disclosure practices. This was subsequently reflected in investors' support levels. As displayed in the chart below, the support for election proposals has been consistently over **89%** since 2018. In line with the above, free float participation support for election proposals has also been increasing from 2018 to 2021. It is worth mentioning that in 2020 and 2021, despite the difficulties that boards have faced during the COVID crisis, the level of support has increased for free float participation and has only seen a very slight decrease (**0.1%**) in total participation levels of support between 2020 and 2021.

In total participation, the in-favor voting increased from **90.4%** in 2018 to **96%** in 2020. 2019 saw a slight decrease of **0.6%** in participation only to rise by **6.2%** in 2020. Similarly for free float participation, in-favor votes gradually increased from **78.7%** in 2018 to **90.6%** in 2021, showing a total increase of **11.9%**. 2018 was the lowest year for in-favor election votes by free float participation with **78.7%**. However, this remains in line with the overall inclination towards over **70%** majority voting by both strategic shareholders and total participation. Thereby, the major issues in 2021 have not materially changed.

Overall, both the total and free float participation voting records for ATHEX 25 companies, indicate a very high voting record in-favor of the in discharge and election proposals.

BOARD OF DIRECTORS - ATHEX 25



As for the discharge proposals, since 2018 total participation seems to show an overwhelming support that has not fallen below **98.3%**. Similarly for free float participation, during the past four years the in-favor votes were over **96.7%**. 2021 showed a slight increase of **0.4%** in the free float in-favor votes, while the total participation rates remained identical.

The provisions of the new law tightened the legal framework on corporate governance for listed companies in a number of ways.

Among the most salient provisions, vis-à-vis the previous framework, are the obligation to adopt a suitability policy that sets the eligibility criteria for the appointment of board members, the new requirement that the chair of the board should be a non-executive member, and the mandatory establishment of a remuneration and nomination committee at board level.

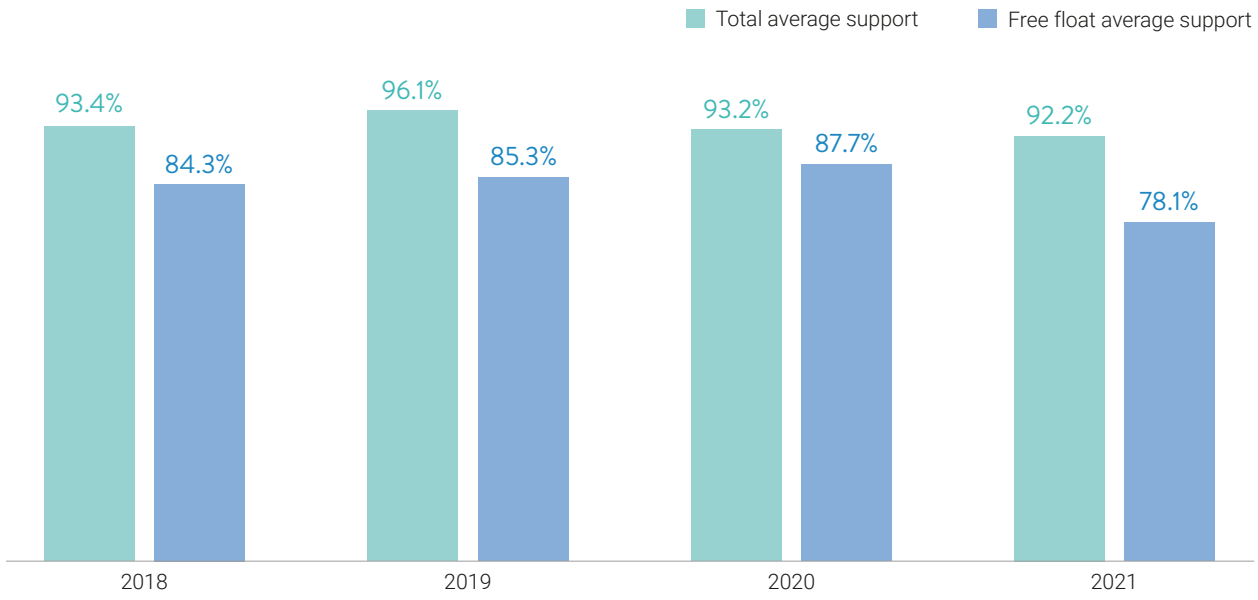
It also sets a gender representation requirement that at least **25%** of either gender shall be represented on the board, and a new obligation to establish an internal control framework that includes risk management, compliance and the internal audit functions.

> "Greek listed companies must present their shareholders with a remuneration policy for the members of the board and for executive directors at least every four years."

REMUNERATION

Starting from 2019, resolutions concerning executive remuneration are substantially the approval of the remuneration policy and the remuneration report, in addition to the approval of equity incentive systems and fees for both executive and non-executive directors, when bundled together.

REMUNERATION - ATHEX 25



Greek listed companies must present their shareholders with a remuneration policy for the members of the board and for executive directors at least every four years.

The annual general meeting also approves a report on the remuneration paid in the previous fiscal year on a yearly basis.

All in all, remuneration items presented at ATHEX 25 AGMs met a significant dissent during the 2021 proxy season, with a decrease in minorities' average vote support of almost **10%** year-on-year (light blue column), leading to a resulting decrease of roughly one percentage point in overall average approval rate, if including votes cast by strategic shareholders (teal column).

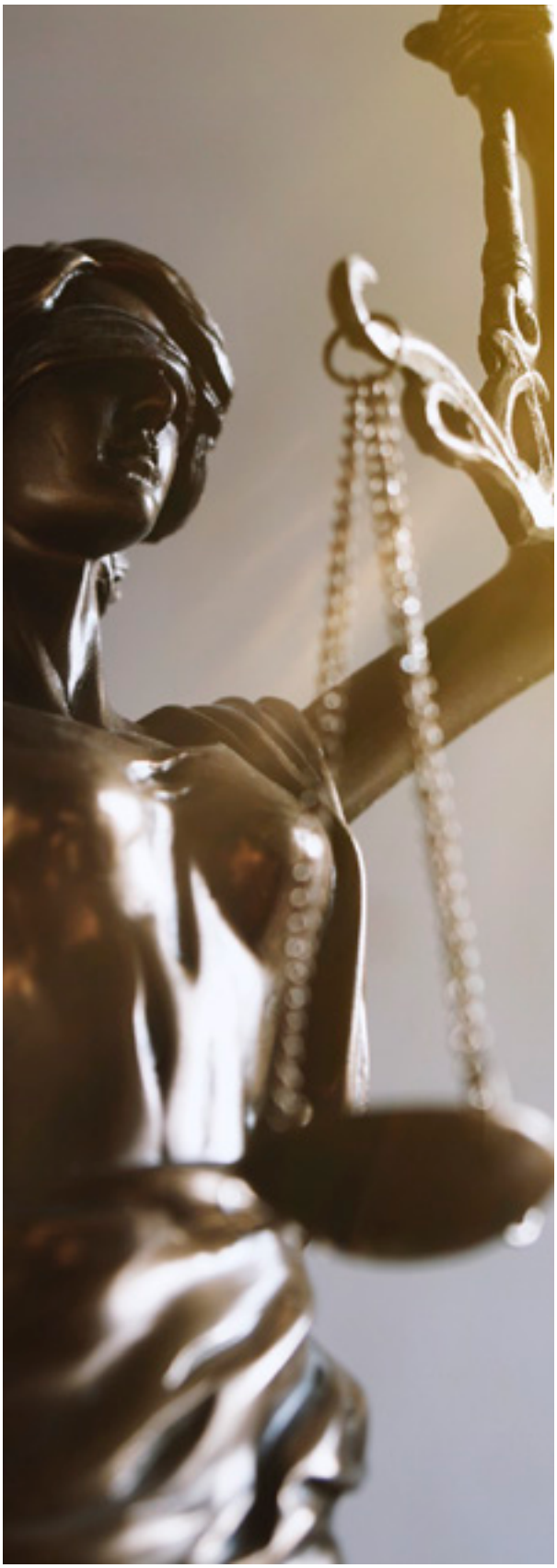
The average decrease in support levels can be associated with moderate recent increases in the free float component of the ATHEX 25 issuers, as well as investors' intensified attention to remuneration issues, especially for ex-post disclosure, given a fiscal year significantly impacted by the COVID pandemic. This trend has reverted the positive one related to fiscal years 2018 to 2020. ISS and Glass Lewis, the two most influential proxy advisors in Greece, have remarkably voted against circa **45%** of ATHEX 25 remuneration resolutions.

LEGAL UPDATES IN GREECE

In 2020, implementing EC Directive 2017/828 into national law, Greece replaced Law 3016/2002 by passing a new law regulating the corporate governance of listed companies (Law 4706/2020). At the outset, of particular interest is the Code's structure; apart from setting out the mandatory legal provisions relating to each topic of corporate governance, the Code includes special "comply or explain" provisions that must be complied with or, in case of non-compliance, an explanation must be provided. The Code also provides some non-binding recommendations that form good practice examples and guidance for companies.

Key points of the new Code, include:

- The adoption, through a "comply or explain" provision, of a policy on diversity, as part of the legally required suitability policy, that sets out specific quantitative gender representation objectives, that extend beyond the board to senior management;
- The board should further collectively be able to understand environmental, social and governance topics within the general strategic framework of the company;
- A "comply or explain" provision on designating a senior independent director among the independent board members in case the chair of the board is a non-independent, non-executive board member; and
- A "recommendation" that independent, non-executive directors shall not be less than one-half of the total number of the board members.



ITALY

GENERAL MEETINGS UNDER COVID REGULATIONS

The 2020 quorums at the Italian FTSE MIB AGMs did not appear to be impacted by the COVID pandemic and showed stable growth in both overall participation and that of institutional investors. However, 2021 registered a significant decrease in total voter turnout. Conversely, the participation of minority shareholders has further increased (**+1.1%** year-on-year), confirming the trend of past years.

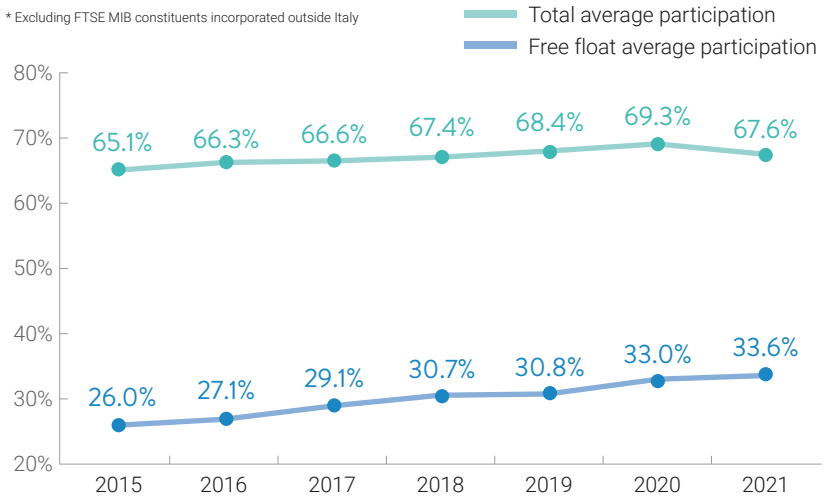
The 2021 Italian AGMs took place under the flexibility of the regulation *"Cura Italia Decree"*, published in March 2020, with a validity term initially set for March 30th, 2021, then postponed until July 31st, 2021.

The law included measures to help Italian public companies deal with the impact of COVID, namely:

- The possibility to convene the AGM to approve the financial statements within 180 days from the end of the fiscal year.

However, the right to attend the shareholders' meeting and to exercise voting rights could only take place remotely through the designated representative.

QUORUM - FTSE MIB*



Accordingly, the decrease of the overall quorum to **67.6%** of capital in 2021 (down **1.7%** compared to 2020), appears not to be a direct consequence of COVID measures but it can otherwise be explained by the increasing weight of the minority shareholders in the ownership structures of FTSE MIB companies.

The graph displays the average total and free float participation at Italian AGMs. For 2021, results are calculated based on 33 FTSE MIB issuers. The sample does not include index constituents that are incorporated abroad (e.g., Ferrari, STMicroelectronics, etc.) and companies that hold their AGM in the second half of the year.

Remarkably, only one issuer registered over **85%** of attendance in capital, and a few others over **80%**. In fact, over **70%** of the free float took part in the voting at the AGMs of four companies, one of which had a dispersed ownership structure.

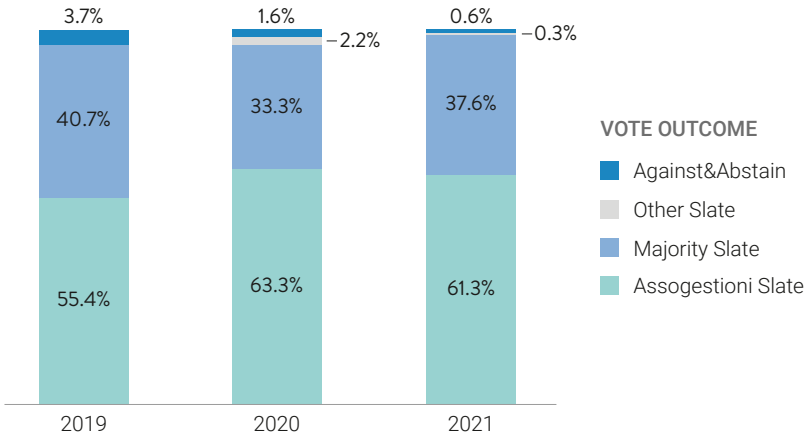
> "The 2021 Italian AGMs took place under the flexibility of the regulation *"Cura Italia Decree"* [...]. The law included measures to help Italian public companies deal with the impact of COVID."

BOARD

During the 2021 proxy season, only seven FTSE MIB Italian issuers presented shareholders with resolutions for the renewal of their boards. Although the law allows for fewer years, director mandates' term is usually set at three years.

In three cases the outgoing boards had presented its own list, managing to achieve the majority of votes. Often, Italian issuers in which a list of candidates is presented by the outgoing board are characterized by the absence of a reference shareholder and a dispersed and widely-held ownership structure. Typically, in order to achieve a wide consensus, the company puts in place a well-structured and transparent selection process, and the management makes itself available for engagement with institutional investors. In fact, the resulting overall practice has been widely recognized by receiving support from minority shareholders and favorable recommendations from proxy advisors.

BOARD ELECTIONS - FTSE MIB



The just mentioned consideration hints at the graph's outcome, particularly with regards to results related to 2021. In fact, this year the majority slate saw an increase in average support by **4.6%** compared to 2020, despite the increasing weight of institutional investors in the capital.

Note that, by definition the majority slate is the most-voted list at elections, regardless of whether it is submitted by the largest shareholders or the boards themselves. Clearly, lists presented by outgoing boards are increasingly supported by shareholders, probably given the application of best practices in the submission, from the transparency of selection processes to the engagement with investors. Another plausible rationale for a shareholder to support management slates is the possibility to express approval of management activity, as a way of recognition of good performance. If enabled, boards are therefore apt to present their list to ensure and facilitate continuity in their work and that of top management.

The goal of institutional investors is not to take control. In Italy, given the election system through slates, institutional investors are granted the opportunity to be represented in the corporate bodies.

However, in a few recent cases (such as BPER Banca in 2021) slates presented by minority shareholders have received more votes than majority ones, which traditionally submit incumbent management.

When slates submitted by minority shareholders turn out to be the most voted, thus failing to appoint all the available board positions, the minority shareholders have so far allowed the majority ones to appoint via direct election in the assembly, one by one, the candidates for the remaining posts, so that to allow the completion of the governing body.

REMUNERATION

On an annual basis, prior to the AGM, Italian issuers are required to release a document on the remuneration of top management and the other main governing bodies. This is composed of two sections:

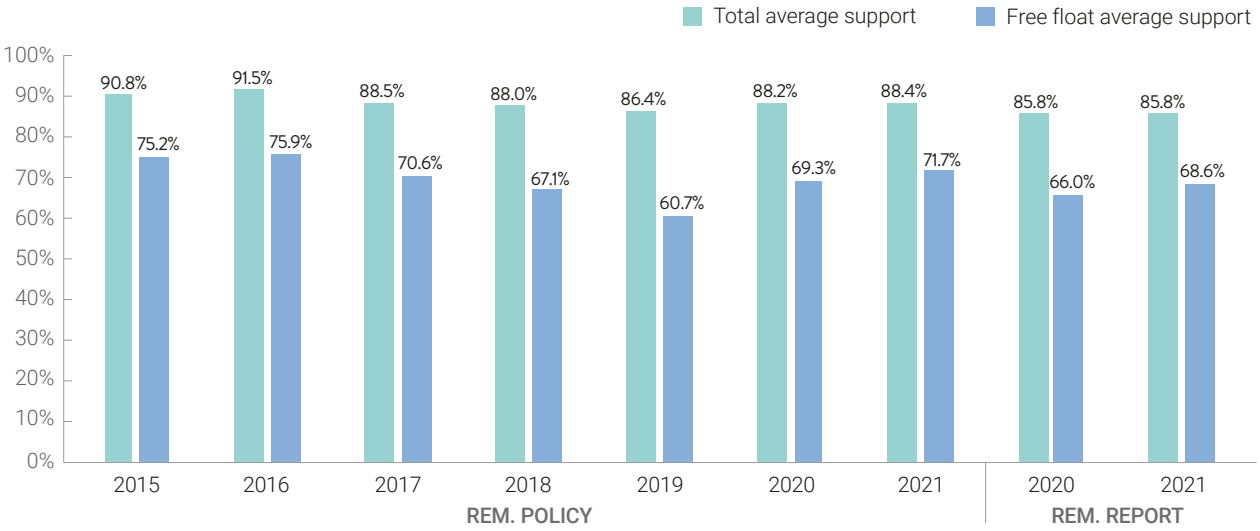
- **Section 1** - The remuneration policy which shall be approved by shareholders via a binding vote at least every three years, or whenever changes are proposed.
- **Section 2** - The remuneration report on fees and other remuneration paid in the previous fiscal year, voted every year.

Starting from 2020, the influence of institutional investors over remuneration policies has increased significantly, considering that shareholders are called to submit a binding vote for the ex-ante approval of the remuneration policy.

In a few cases, such as BFF Bank which is outside the FTSE MIB perimeter, **the management-proposed remuneration policy was rejected at the AGM.**

Overall, average support of executive remuneration at Italian FTSE MIB companies slightly increased if compared to 2020 support levels. In particular, the approval results of the remuneration policy increased for the second consecutive year, including free float support level, despite negative recommendations from proxy advisors in almost half of reports released for the Italian FTSE MIB constituents. The main investors' concerns relating to the remuneration policies remain severance agreements and the possibility to grant bonuses to executives not pre-emptively approved by the shareholder assembly. When considering discretionary compensation, companies should be aware of the potential negative perception by the market, it especially concerns those companies that have suffered a significant impact from the pandemic and have consequently had to reduce their workforce.

AVERAGE SUPPORT TO REMUNERATION POLICIES AND REPORTS - FTSE MIB



2021 was the second year in which shareholders could cast an advisory vote on fees and other remuneration paid in the previous fiscal year. Interestingly, the overall approval rate has remained unchanged year-on-year except for the free float component, which registered a slight increase. Institutional investors' main criticisms were directed at excessive executive quantum and payout in comparison to performance and/or peers, as well as adjustments to remuneration which were poorly justified. These latter particularly increased in 2020 for obvious reasons related to the pandemic, and where companies failed to provide sufficient disclosure around their activities and the respective rationale, investors often opposed the resolution.

BENEFIT COMPANIES AND SUSTAINABLE PURPOSE

In 2016, the Italian regulatory framework was updated to introduce the possibility for firms to become benefit companies: a form of profit-making company characterized by a higher level of transparency, enhanced accountability and a purpose expanded to sustainability and stakeholders' satisfaction. In fact, by integrating the corporate purpose, the benefit company undertakes to consider the interests of all stakeholders, not just shareholders.

Thus, why should a traditional for-profit company adopt the benefit status? The company can expect an improvement in its reputational profile:

- The adoption reflects the company's commitment to achieving long-term sustainability goals, potentially leading to greater attractiveness for investors who integrate investment strategies with ESG metrics.
- The promotion of corporate transparency helps build trust with stakeholders.

While the Italian corporate landscape already has more than 900 benefit companies, no listed Italian companies have yet adopted such status. However, a few issuers have opted for an alternative solution: in a "softer" version than the status of benefit company, where there is the possibility to introduce, through a bylaw amendment, a corporate purpose specifically oriented to long-term sustainability. The new mission promotes the principle of the pursuit of sustainable success among the purposes to which the company's business activities must comply, through the creation of long-term value for the benefit of all shareholders and, at the same time, promoting the interests of the stakeholders relevant to the company. Therefore, unlike the benefit company, the main objective remains the satisfaction of the interests of the shareholders but reinforces the consideration given to stakeholders' interests.

On February 2nd, 2021, the Italian listed company Snam proposed at the shareholders' meeting the inclusion in the bylaws of **the sustainable corporate purpose, under the name of "energy to inspire the world"**.

The principle of the pursuit of sustainable success is now amongst the purposes that must be pursued within the company's business, through long-term value creation to benefit shareholders and, at the same time, the promotion of the satisfaction of the interests of the relevant company's stakeholders.

The inclusion aims at *"fostering the energy transition towards forms of use of the energy resources and sources that are compatible with environmental protection and the progressive decarbonization"*.

PORTUGAL

The Portuguese market and PSI-20 issuers are very concentrated in terms of equity ownership.

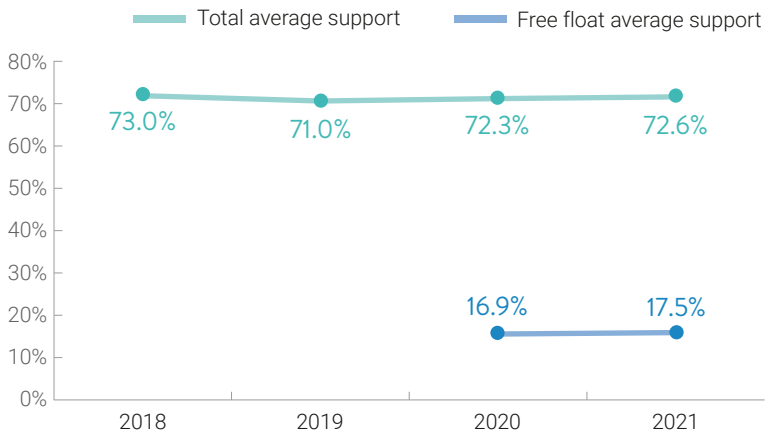
In 2021, on average, **55.1%** of the PSI-20 issuers' equity was held by strategic and controlling shareholders (for instance, this average level was **35.2%** in Spain, nearly 20 percentage points less). In other words, most of the voting power in Portugal, which is a one-share one-vote market, is in the hands of company founders and big strategic investors such as international sovereign funds and other companies (parents), making the free float a minority of the market (**44.9%** of the total shares on average).

GENERAL MEETINGS UNDER COVID REGULATIONS

The average participation at PSI-20 proxy seasons has remained consistent across the years despite the disruption of the pandemic and all the restrictions created by COVID. Indeed, the 2021 proxy season recorded an average quorum similar to the past three occasions, slightly improving the previous year's quorum (**72.6%** versus **72.3%**).

The average participation of the free float also remained very stable and, despite the aforementioned problems, it grew from **16.9%** in 2020 to **17.5%** in 2021.

QUORUM - PSI-20



BOARD

Portuguese issuers tend to appoint classified boards, amongst other corporate bodies, in slate elections for a three-year period. Individual elections are only voted when a nominee is appointed to the board to replace an outgoing director.

When it comes to the discharge of the board, the level of average support is very high. In 2021, on average this item was backed by **98.4%** of the votes, with the lowest single item receiving **83.6%** support – which is not a concerning level. In line with this, the average supporting votes on the election of the corporate bodies

In 2021, board-related items represented 27% of the total items of the PSI-20 proxy season.

Proxy advisor ISS issued 17 negative voting recommendations in these AGMs. **41%** of those negative recommendations were on board issues, mainly motivated by poor board composition.

Proxy advisor Glass Lewis only issued 10 negative recommendations. **30%** of those were warranted against board items.

In both cases, the number of negative recommendations issued by these two proxy advisors on board-related items outperformed the total number of said items tabled by PSI-20 issuers in 2021.

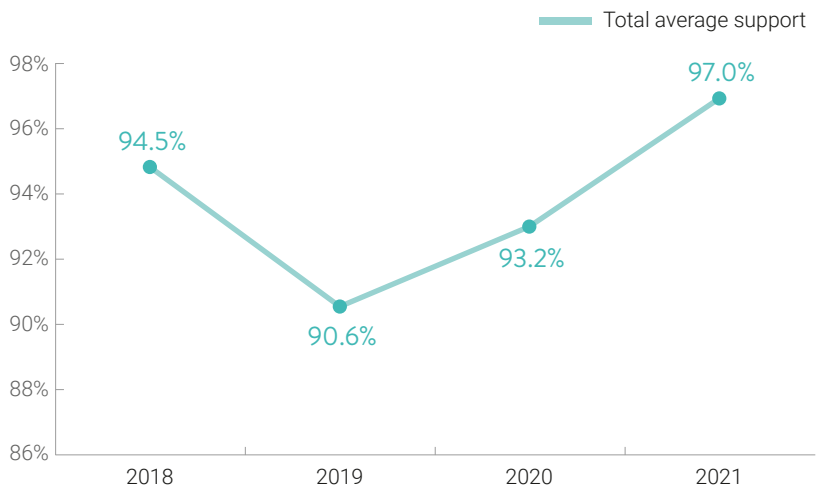
and individual nominees remained high in 2021 (**94.3%**). Coherently, the lowest support to the board elections was received by the same issuer that had also received the lowest support to the discharge of its corporate bodies.

However, while these high average support levels may indicate that in broad terms investors deem board performance and composition positively, the majority presence of controlling and strategic shareholders in PSI-20 issuers' equity may also indicate that, on average, the free float is not interested in raising any concern at AGMs given their inferiority in voting power.

REMUNERATION

The average support received by these items was **97.0%** in 2021, which is a remarkable upturn regarding the levels of the previous proxy seasons. While these average figures show a broad shareholder adherence to the remuneration policies, beating the records of past proxy seasons, some individual issuers received significant opposition levels when tabling this item, fixing the lowest support at **81.2%**. Nonetheless, this still is a significant improvement on the previous proxy season, which recorded negative votes of up to **35.5%**.

REMUNERATION POLICY - PSI 20



Shortcomings such as uncapped bonuses, the participation of non-executive directors in executive remuneration schemes, the lack of severance caps, the absence of clawback clauses, and the existence of too short long-term incentive plans were among the most common complaints of proxy advisors and institutional investors when issuing voting recommendations and casting votes on the remuneration policies.

In 2021, board-related items represented 16.8% of the total items of the PSI-20 proxy season.

35.3% of the negative recommendations issued by proxy advisor ISS were warranted against remuneration-related items. In the case of Glass Lewis, this figure was **30%**.

Similarly to board-related items, the number of negative recommendations issued by these two proxy advisors on compensation-related items outperformed the total number of items under this type tabled by PSI-20 issuers in 2021.

Remuneration remains as an area of concern in Portugal for proxy advisors.

SPAIN[1]

The COVID pandemic has forced issuers to change the form of shareholders' meetings by submitting to shareholder vote certain bylaw amendments following recent regulatory changes. In 2020, urgent legal procedures (royal decree-laws 8/2020 and 11/2020) allowed issuers to hold virtual-only meetings in the FY2020, even if this possibility was not in their bylaws. Later, this temporary measure was extended to 2021.

However, most companies decided to use a provision of the SRD II bill to amend their bylaws in 2021 without needing those extraordinary measures. Such amendment requires the approval by a majority of two-thirds of the votes and establishes the following additional requirement: the participation to the GM through remote means, either audio or video, must be effective and complemented by real-time text messaging in order for shareholders to exercise their rights to speak and interact with management and the board, vote, and table agenda items.

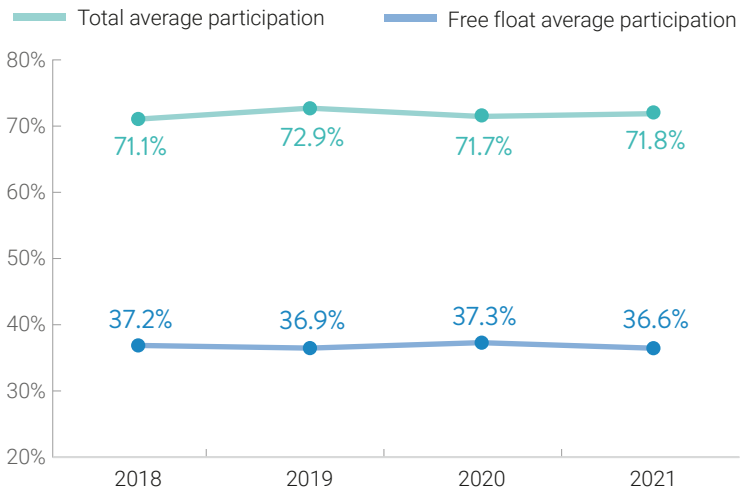
In general, considering the new legal environment and issuers' commitment to hold remote-only meetings only in extraordinary occasions, such amendments were deemed positive by proxy advisors. Shareholder opposition was slightly higher than in other similar items addressing other amendments, but still approval levels were high in broad terms (above **90%** on average).

GENERAL MEETINGS UNDER COVID REGULATIONS

Average participation at Ibex-35 proxy seasons remains constant across the years despite (i) the usual changes in the index composition, (ii) the general disruption created by the COVID pandemic, which impacted investors' ability to participate at shareholders' meetings, and (iii) the escalation of remote-only shareholders' meetings. Proxy season 2021 records a similar average quorum to the past three seasons, slightly improving the previous year's quorum (**71.8%** versus. **71.7%**).

The average participation of the free float also remains very stable at this time. Despite the variety of index constituents being wide (some issuers' free float hit **100%**, while with some others the strategic shareholders hold up to **70.1%** of the equity), the average participation of the free float has not significantly changed in the last four years. In fact, most of the average votes at the Ibex-35 proxy season comes from the free float. Nonetheless, average free float participation at the 2021 proxy season reached the lowest record of the time series (**36.6%** versus **37.3%**).

QUORUM - IBEX-35



The form of shareholders' meetings does make an impact on shareholder participation. Since the beginning of the COVID pandemic and the resulting restrictions affecting physical gatherings, remote-only meetings have increasingly become the most common form of shareholders' meeting. While in 2020, **62%** of the Ibex-35 issuers organised remote-only meetings, in 2021 the percentage grew to **68%**. At any rate, all Ibex-35 issuers offer shareholders the possibility to attend the meetings by telematic means.

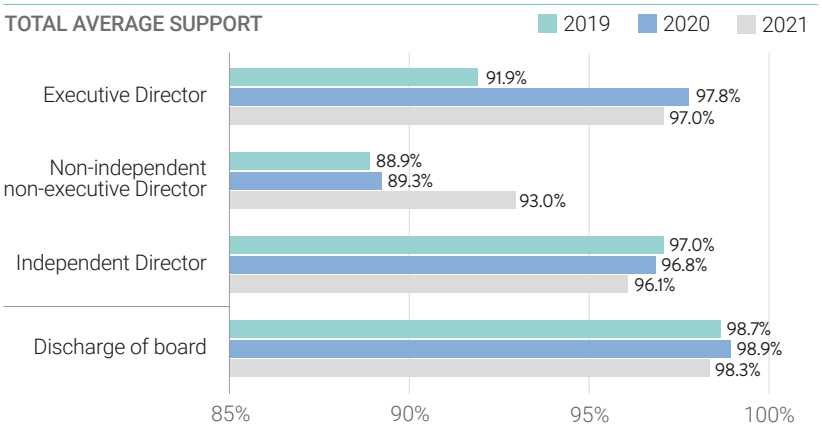
1. ArcelorMittal has been excluded from this research on Ibex-35 issuers given that the form of this Luxembourgian issuer's governance and shareholders' meeting does not follow Spanish parameters.

BOARD

Board-related items represented **24.8%** of the total items of the 2021 Ibex-35 proxy season. Nearly one out of four items addressed board issues, thus becoming the most frequent type of item.

When it comes to the discharge of the board, average support records very high levels. This indicates that this item, which is at times voted jointly with the approval of the financial statements in Spain, is becoming a routine formality. Taking a closer look at the individual voting outcomes, the lowest support was recorded in proxy season 2021 at **90.0%**, which is a reasonably high low.

BOARD ELECTIONS - IBEX-35



Overall support of board elections also remains high in 2021 amongst Ibex-35 issuers. Indeed, in 2021 the average support (**95.4%**) outperforms the levels of 2020 (**94.5%**) and 2019 (**93.6%**). However, support varies depending on the nominee category. The 2021 proxy season confirmed the trend of 2020, which shows that executive nominees received the highest average support levels, while independent nominees are the second most voted candidates. Non-independent, non-executive nominees are the least supported nominees on average. The 2019 voting outcome showed that independent candidates used to be the shareholders' favourites.

Up to 124 agenda items addressed the individual election, re-election, or ratification of this number of nominees to the boards of the Ibex-35 issuers in the 2021 proxy season. While this number is not representative since it broadly relies on the occurrences of board mandates that come to an end, it is interesting to note that proxy advisor ISS only issued eight against recommendations (**6.5%** of the election-related items), based on situations of insufficient board independence, excessive outside boards of the nominees, or the combination of the roles of CEO and chair under a single nominee. This percentage implies a significant decrease year-on-year in the 2018-2021 time series, but mainly regards the 2020 proxy season, where **15.5%** of the election-related items received an adverse recommendation by the said proxy advisor.

In 2021, investors' support also varies on the gender of the nominees. In the case of male nominees, average support amounted to **94.7%**, while female nominees received an average support of **96.7%**.

Interestingly, most female nominees were appointed as independent candidates (**87.8%**), which is a category that in general terms is widely supported by shareholders. In the case of male nominees, the independence also is their preferred status, although it is less frequent (**47.8%** of male nominees).

The occurrence of non-independent non-executive nominees follows closely (**36.1%** of male nominees). The latter is the least favourite director category for shareholders across the genders.

Finally, **67%** of all Ibex-35 nominees in 2021 were male, while the remaining **33%** were female. Only one of the total of 41 female nominees (**2.4%**) was proposed to shareholder election in an executive capacity. Indeed, 12 out of a total of 13 executive nominations were filled by male nominees (**92.3%**).

Interestingly, despite the adverse ISS recommendations in 2021, which were singularly infrequent in election-related items, its influence is still meaningful: the average support in the presence of an ISS against recommendation dropped to **82.6%** (2021), **82.9%** (2020), and **72.9%** (2019). This implies an average downturn of circa 13 percentage points regarding the support to all election items, and circa 15 percentage points regarding election-related items that received only favourable recommendations by ISS.

The new corporate realities triggered by the sudden impact of the pandemic have modified compensation practices too.

However, while proxy advisors and institutional investors remained relatively flexible to accept the extraordinary changes implemented by issuers, there are certain red lines that are still highly controversial.

One of those red lines is the payment of extraordinary bonuses to executive directors. Even when certain amounts are waived to mitigate the damage of the pandemic, the payment of one-offs should be explained in detail and based on disclosed extraordinary achievements in the context of robust financial and economic corporate momentum.

REMUNERATION

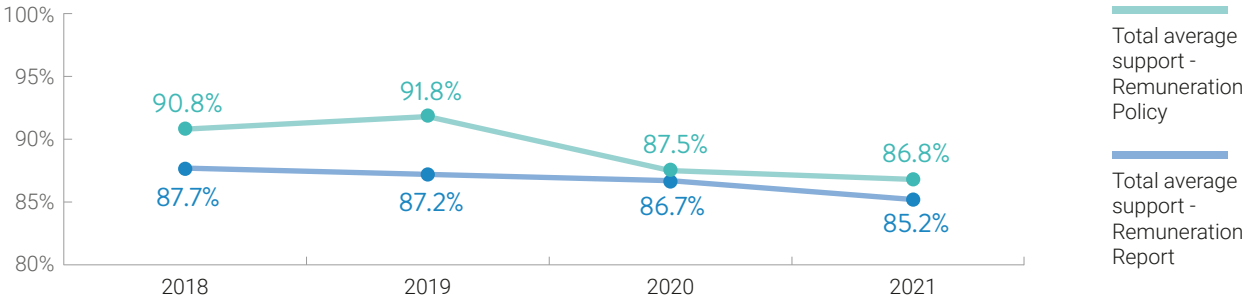
In 2021, remuneration-related items were **14.4%** of the total items submitted to the shareholder vote by Ibex-35 issuers, being the third most frequent type of item at the AGMs, behind board items and those related to the approval of the different financial and legal corporate reports.

When it comes to the annual remuneration report, which most Ibex-35 issuers submit as an advisory item with the sole exception of two companies, the average support was **85.2%** of votes, which is worse than the level recorded in 2020 by more than one percentage point. This low average level relates to the concerning cases of up to nine Ibex-35 issuers, who in 2021 received the support of less than **80%** of cast votes under this item. Remarkably, one of them failed to approve the advisory remuneration report, which implies that a remuneration policy will have to be submitted to the binding vote of shareholders in 2022. This was, in fact, the only item in the 2021 Ibex-35 proxy season that has not passed.

Regarding the voting outcome of the binding approval of the remuneration policy—a forward-looking document that describes the company's approach on board and executive compensation for the following three years—the average support in 2021 recorded **86.8%** of the votes. As usual, shareholders tend to be less strict when voting on this item than when voting on the remuneration report. Nonetheless, the average support in 2021 is slightly lower than in 2020.

In both cases, shareholder opposition is a growing factor that, on average, makes these two items the most controversial at Ibex-35 shareholders' meetings in terms of support. This is an increasing concern for all issuers as shareholders are very sensitive to remuneration aspects.

REMUNERATION REPORTS AND POLICIES - IBEX-35



Despite the diminishing levels of shareholder support, proxy advisor ISS had issued 15 against recommendations under these types of items (**15.5%** of these items received an against recommendation by ISS). This percentage implies a significant decrease year-on-year in the 2018-2021 time series, but mainly regarding the 2020 proxy season, where **24.4%** of these items received an adverse recommendation by the said proxy advisor. Consequently, institutional investors do not seem to relax their stringency on remuneration items regardless of proxy advisors' recommendation trends.

CLIMATE AND ENVIRONMENTAL ACTION IN SPAIN

Spain was the first county in the world that passed a law that mandated issuers to annually submit their externally assured non-financial information to the binding vote of shareholders under a separate agenda item. While this was firstly implemented in the 2019 proxy season, proxy advisors and most institutional investors keep relying on the auditor's opinion to decide their vote.

Nonetheless, certain new developments and actions have appeared at shareholders' meetings regarding climate matters, proving that the appetite of investors for these items is not yet satisfied. In the 2021 proxy season, up to three different Ibex-35 issuers decided to table specific climate-related items (four in total), besides the release of their annual non-financial statements. Three of these items addressed the climate strategy and action plans and were prepared following the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the Climate Disclosure Standards Board (CDSB). One of them includes the evolution of emissions of the different business activities, facilities, and assets over which the company maintains control, in accordance with international standards (ISO 14064 or equivalent), indicating annual progress with respect to the company's Greenhouse Gas Emissions Reduction Plan, and the Report was verified by an independent body, in accordance with specific internationally approved auditing standards (ISAE 3410 or equivalent). The fourth item addressed a Greenhouse Gas Emission Reduction Plan, which included a four-page document where the company provided (i) an overview of its GHG emission reduction track record for the period 2009-2020; (ii) its plan for the period 2020-2030; and (iii) forecast from 2030 to 2050.

For the moment, these were proposed under a voluntary vote and were strongly backed by shareholders (all four items received more than **95%** votes in favor). Proxy advisors' opinions were unequal, which shows room for maturing, given that their policies tend to share similar views in most conventional matters: while ISS recommended in favor of all these items, Glass Lewis decided to recommend not in favour of three of them.

Shareholders and proxy investors unanimously backed non-financial information statements that issuers proposed under binding separate items. Both ISS and Glass Lewis recommended in favo-r of all these resolutions and the average support was **99.4%** of votes.

While these approval levels imply that issuers perfectly adjust their non-financial contents to the expectations and demands of investors, proxy advisors and shareholders, it may also indicate that the way this information is tabled may not be relevant given that most parties address these items' voting as a routinary formality, which contrasts with the dynamic character of ESG matters.

SWITZERLAND[1]

Two institutional investors took the opportunity to comment during the general meeting of Sika, who allowed live Q&A during their general meeting 2021.

Physical meetings were generally not allowed under the COVID ordinance, which is expected to be softened for the 2022 proxy season.

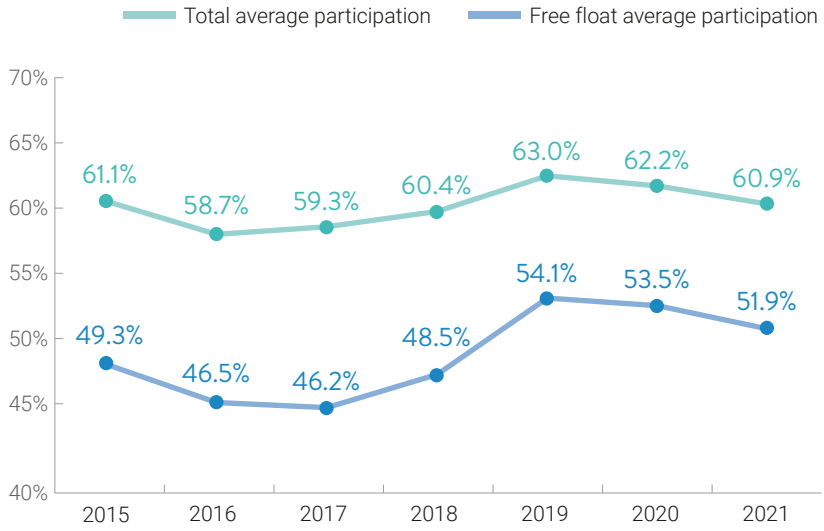
With the updated stock corporation law, virtual general meetings will generally become possible from 2023. Prior to a corresponding amendment to their articles of association, companies should develop a clear plan on how shareholder questions, comments and live voting can be implemented by looking at relevant issuer experience at home and abroad.

GENERAL MEETINGS UNDER COVID REGULATIONS

Participation levels at Swiss general meetings have decreased for the second consecutive year. Technical issues around the voting process and re-registration requirements have largely been resolved, however, free float investors are voting less than in previous years.

A closer look at the data shows that the majority of Swiss Market Index (SMI) companies have actually experienced a small increase in free float participation. This indicates that neither concerns around perceived share blocking have returned nor are investors voting less without physical participation. Instead, the average decline was mainly driven by significant changes in shareholder structure and a resulting steep decline in the participation of a minority of Swiss issuers.

QUORUM - SMI



> "Physical meetings were generally not allowed under the COVID ordinance, which is expected to be softened for the 2022 proxy season."

1. Richemont do not publish their general meeting results and have therefore been excluded.

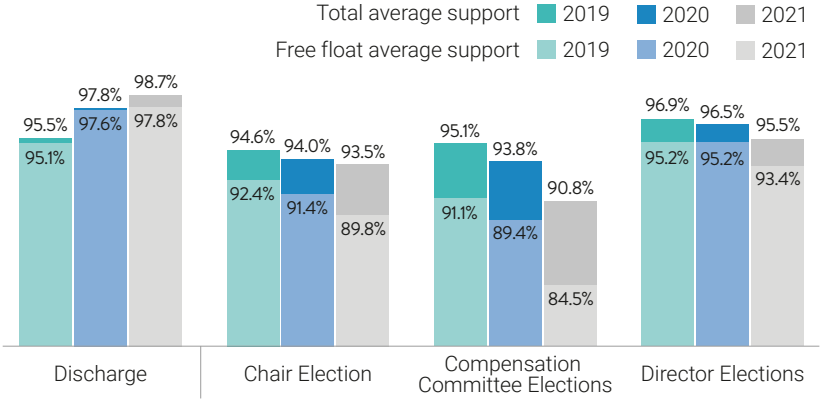
BOARD

Support on discharge items increased substantially, indicating that investors were generally satisfied with how boards handled the COVID pandemic.

Overall approval of director elections decreased only slightly. However, free float investors increasingly hold specific directors to account. Support for chair and compensation committee appointments dropped to **89.8%** and **84.5%** respectively. Independence, overboarding and remuneration related concerns remain at the heart of low approval rates for company proposals. In 2022, this list is expected to be extended to include:

- Gender diversity on the board as well as associated initiatives throughout the company.
- Governance of environmental and social risk and impact, in particular the board's oversight thereof.

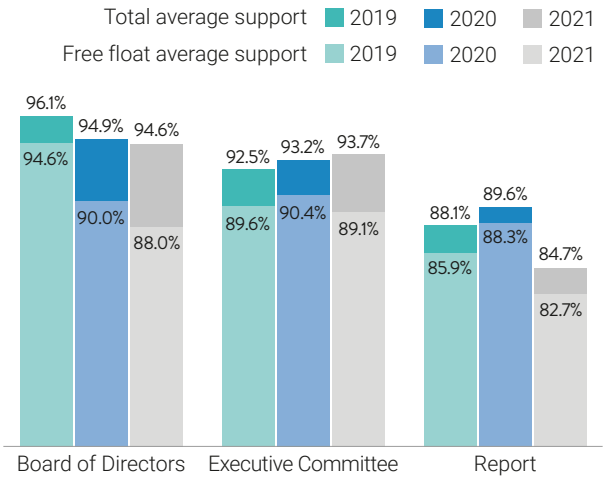
BOARD OF DIRECTORS - SMI



30% minimum representation of each gender on the board is expected by ISS and Glass Lewis for SMI issuers from 2022. Although exceptions may apply for non-SMI companies based on size and shareholder structure, many Swiss issuers who do not have to comply with gender quotas unlike other European issuers will struggle with this requirement. Individual shareholders may even expect **40%**. Just under **30%** of election items in 2021 proposed a female director or chair.

Repercussions can impact chairs, nomination committee members or male nominees in general. Companies who can foresee problems in meeting diversity requirements at board level may consider early engagement with institutional investors informing them of longer-term initiatives and targets at and below board level to support their strive towards more diversity.

REMUNERATION ITEMS - SMI



REMUNERATION

While approval rates on binding board and executive committee remuneration remain high, average support on remuneration reports fell below **85%** in 2021, with one advisory vote failing to reach a majority.

Application of discretion, including (but not limited to) COVID-related adjustments, and an associated lack of transparency were the main drivers behind lower approval. The overall low level of disclosure on targets, target achievement and individual remuneration outcome in Switzerland compared to other European markets is expected to remain problematic going forward, also exacerbating investor scrutiny of extraordinary remuneration decisions.

95% of votes were submitted in support of Nestle's advisory vote on their "Climate Roadmap".

Nevertheless, some investors such as Norges or Calpers and proxy advisor Glass Lewis voiced concerns that such proposals may pave the way to delegating ESG oversight from the board to shareholders or even replace shareholder engagement on ESG topics. Companies considering similar proposals should explicitly address these concerns in their general meeting materials.

SAY ON CLIMATE (AND SUSTAINABILITY)

The SMI saw its first Say on Climate proposal this year. In the context of similar proposals by shareholders and management alike, proxy advisors are expected to refine their guidelines on the issue, which may already affect further voluntary Say on Climate resolutions in the upcoming season. In preparation for the advisory vote on non-financial reporting companies will need to look beyond climate:

- Established reporting frameworks such as the Global Reporting Initiative (GRI), the Value Reporting Foundation (SASB) or TCFD provide guidance and should be perceived as complementary considering sector, strategy and maturity of a company.
- As proxy advisor and investor expectations are still very much evolving, engagement on non-financial reporting as well as related strategic decisions should be considered a two-way street.

With a vote on the sustainability report in 2024, Swiss companies should focus on an evolving discussion about their sustainability strategy beyond climate, continue to refine their materiality assessment and decide about the use of reporting standards and specification of assets relevant to their risks and opportunities. By including all stakeholders in this dialogue on relevant implementation, a clear explanation on how the board is overseeing ESG remains important.

UNITED KINGDOM

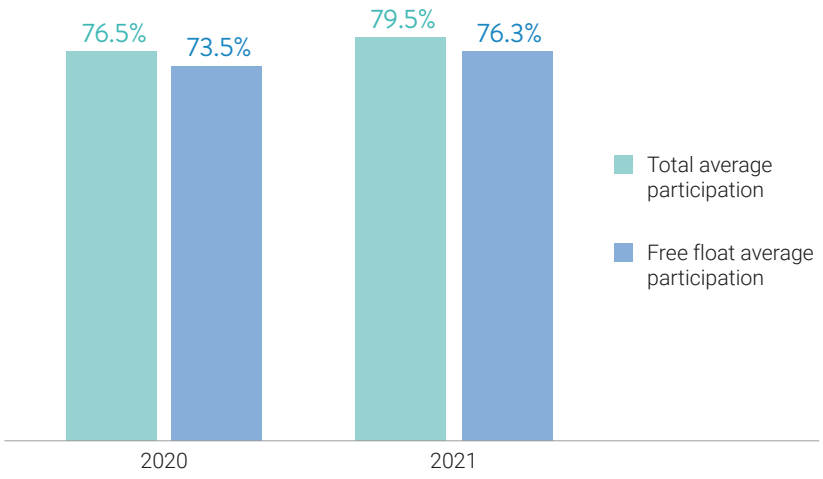
GENERAL MEETINGS UNDER COVID REGULATIONS

If 2020 saw the world of issuers and shareholders coming to terms with how to tackle and navigate the myriad of obstacles and challenges thrown up by COVID, 2021 largely told the story of how well that was accomplished. With the notion of dividends and capital expenditure dealt with across COVID's first year, the second saw attention turn to more traditional governance topics in the landscape of the "new normal".

What did we expect to see? Certainly a rigorous assessment of board accountability across all committee disciplines. Board chairs and members are being assessed for accountability in: **Nomination** – measured especially against diversity thresholds and succession plans; **Remuneration** – measured against the workforce and shareholder experience; and **Audit** experience measured against prior associations (e.g. Wirecard AG).

As regards **shareholder turnout**, we already knew from a frantic 2020 that institutional participation was unimpeded by COVID owing to the standard use of platforms and digital voting.

QUORUM - FTSE 100



Company secretariats were eager to enfranchise as many shareholders as possible within the bounds of their Articles, and the 'virtual' platforms must never have had it so good. There were jokes about mailing the *tea and biscuits* to compensate for the demise of traditional, physical attendance, but the virtual methodology appeared well-received overall, and at least not greatly challenged. **As the chart above demonstrates, turnout increased by three percentage points year-on-year.**

Four shareholder proposals are generally rare in the UK, requiring fairly significant hurdles of ownership and legal consultation to ensure they get on the agenda – factors that make them the preserve of activists and constructivists. That said, the big hitters do attract attention from concerned shareholders. In 2021, we saw four proposals tabled at four of the Financial Times Stock Exchange (FTSE) 100 compared to three in 2020. Of all these proposals, **four** have been **ESG-driven**, while **two** were **remuneration-related**. The recipients of these were predictably petrochemical entities and top-tier banks. Only one resolution was re-tabled year-on-year, and this concerned the setting and publishing of targets for greenhouse gas emissions.

Whilst **none of these proposals were successful**, the **most supported were under the Environmental, Social, and Governance (ESG) banner**, and in 2021 overall support for this was enhanced by over three percentage points.

Eight FTSE 100 directors secured sub-optimal support of below 80% in 2021, whilst a further 42 took the broadside warning in the **sub-90%** category.

So just what is it that takes a director to the Investment Association's "naughty step" (Public Register)?

Overboarding
Mathematical intolerance of time commitments (five directors hit)

Committee escalation
Poor *remuneration* practices / *diversity* / *sustainability* oversight failure (five directors hit)

Non-independence on committees
(one director hit)

The director with the least support (**sub-55%**) carried a combination of all the above three factors.

That said, in its Regulatory News Service (RNS) statement acknowledging the high dissent along with meeting results, the company only referenced the singular issue in that, "shareholders, for a range of specific, principled and technical reasons, have been unable to fully support the company's chosen approach to remuneration".

Clearly the underlying issues were deeper and wider. We fully expect escalation to continue with force into 2022.

BOARD

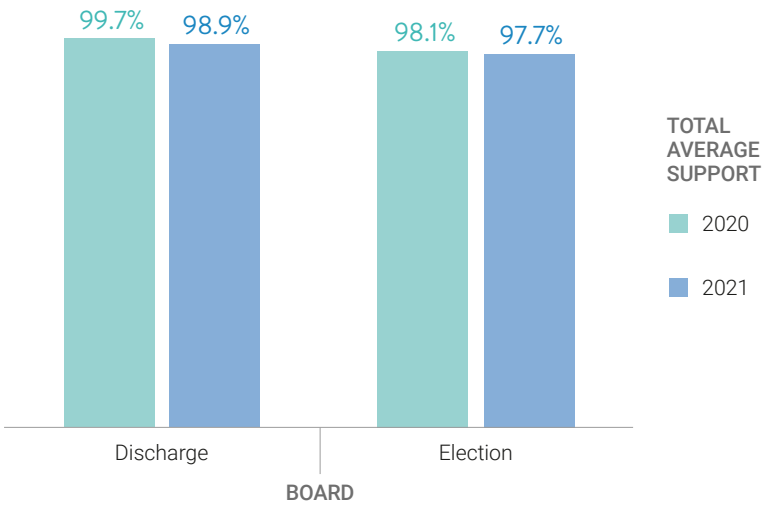
When holding individual directors accountable over strategy, performance and best practice, investors were less relaxed over re-appointments in 2021. Whilst the big picture shows high levels of support (**>97%**), there was a modest drop in 2021, and the number of directors elected with **more than 20% of against** votes has increased from **two** to **six** year-on-year. That is a ***200%*** *increase in the FTSE 100* where the corporate governance teams are strongest.

In these instances, investors cited issues relating to:

- Concerns about **time commitments**.
- Escalation against the Nomination Committee accountable for failing to ensure that all key board committees are fully **independent**; and for failing to ensure adequate **diversity**.
- Escalation against the Remuneration Committee accountable for questionable **remuneration practices**.
- Crucially, **lack of responsiveness** to prior flags raised is also a reason for escalation, i.e., whereby **concerns have not been adequately addressed** – also a main underpin for proxy advisors recommending against.

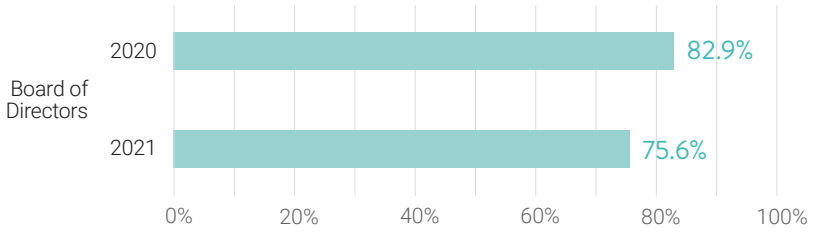
Note: the proposal to *discharge* directors from "liability" is a non-standard UK proposal and reflects dual-listings and such geographies where this is normal practice. Such a resolution tends to pass as a formality but can be a target for concerned shareholders where practices, in particular **audit** are perceived to have been damaging.

DIRECTOR ELECTIONS - FTSE 100



WHEN ISS AND GLASS LEWIS ARE AGAINST

TOTAL AVERAGE SUPPORT



Notably, where the most influential proxy advisors, ISS and Glass Lewis have recommended against, there is a direct correlation to the drop in the level of support.

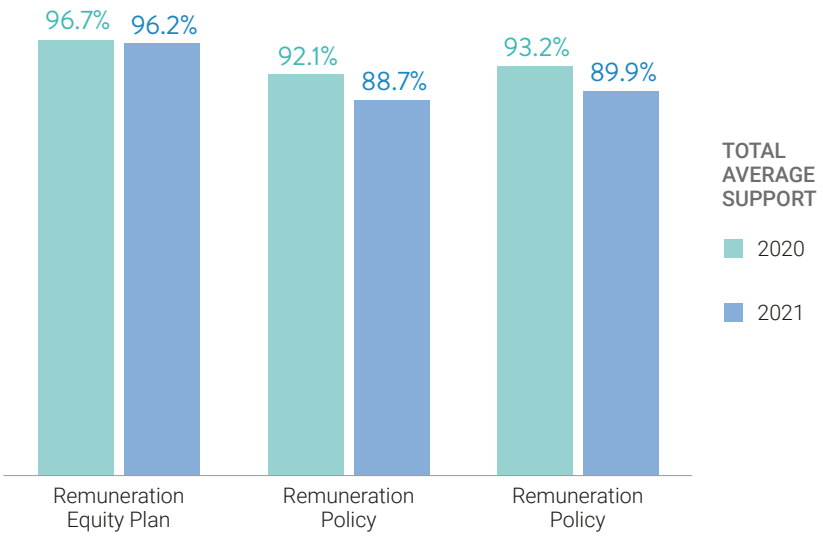
REMUNERATION

Last year, we predicted that in 2021 there would be an increased level of scrutiny over remuneration reports, given that they would reflect the decisions made during the initial phases of the pandemic. We expected comprehensive explanations about how investors and wider stakeholders had been considered in, for example, discretionary adjustments to criteria, targets or pay outcomes.

Many FTSE 100 issuers renewed their three-year remuneration policies in 2020 (**60** companies compared to **27** in 2021), so this last season has mainly been about the remuneration reports themselves.

That said, **six** policies were subject to greater than **20%** dissent.

REMUNERATION PROPOSALS - FTSE 100



Four incentive proposals

took hits of over 20% dissent, with the worst (being an amendment to a *Performance Share Plan*) passing at just over **60%** approval. In this case, investors saw the clear potential for excessive quantum, significant increases to variable pay for a second consecutive year, and a non-compelling rationale. Notwithstanding a reduction in pension contributions lowering the proportion of fixed pay, *the overall increase appeared just too high*.

Elsewhere, two **Long-term Incentive Plans (LTIPs)** were shouted at: one because it could grant significant awards to Executive Directors (Eds); and the other because of an increase in total payout without corresponding increase in performance expectations; a **Restricted Share Plan** also got roasted because equity awards should be linked to stretching performance targets rather than to *time*.

REMUNERATION POLICIES

- **Six** policies received dissent of over **20%** in **2021** and **eight** policies in **2020**.

A year-on-year drop is to be expected given the volume up for approval, *but not a great one*, and therefore the difference is all the more significant.

Five key objections cited included concerns over:

- **Potential for excessive quantum** and a **short performance period**.
- **Significant increases to variable pay** for a consecutive year, and the rationale for this is not compelling; excessive increase in LTIP; too much vesting at median or threshold.
- **Restricted Share Plan** – permits significant time-based awards that are not subject to conventional performance conditions.
- **Excessive pay levels** and **lack of performance-related pay**.
- **Delayed alignment of executive pension** contributions to the wider workforce – *"market- lagging"*.

REMUNERATION REPORTS

- **Eleven** reports received dissent of over **20%** in **2021** and **four** reports in **2020**.

For the two fails at **<40%** support, such reasons were cited:

- **Remuneration practice** – It allowed a Senior Executive leaver to retain a significant proportion of outstanding LTIP awards, subject to pro-rating for time and performance; absence of further downward discretion. Remuneration committee discretion has been used poorly.
- **Remuneration practice** – Retrospective changes to performance conditions/Lack of performance related pay/Inadequate response despite low support at last Annual General Meeting (AGM).
- **ESG** – failures in risk oversight and governance constitute a "catastrophic environment event" which has "had a **material effect on the reputation**", as defined in the *malus and clawback* provisions.
- **Escalation against committee members** - Owing to Remuneration Policy not being aligned with long-term shareholder interests and concerns about lack of ESG performance criteria.

Otherwise, key objections disclosed included concerns over:

- A key executive receiving a **significant salary increase** above the median for the FTSE 100 which was **deemed excessive**.
- **Significant salary increases** that are not linked to material changes in the business or in the role and responsibilities of executive directors.
- Remuneration committee exercising discretion to address **retention concerns** meaning an award of **significant salary increase**.
- A Chief Financial Officer (CFO)'s **salary increased** by **7%** in 2020 after an uplift in the same year **in line with the Company's UK workforce, and a further 4%** increase in October 2020 following the expansion of role.

UK SPECIFIC

As far as meeting agenda proposals can be attention-grabbing, Say on Climate resolutions have been the stand-out new entry to the resolution hit-parade. Both boards and shareholders have been putting forward proposals on climate-related matters, thereby inviting debate as to which merits support based on relative long-termism, demonstrable underpinning and the correct appropriation of accountability. In the UK, from management, we have seen one item in 2020 compared to eight in 2021; and from shareholders, two compared to three year-on-year. Notably, these include high-tier banking institutions and not just companies in extractives and heavy industry. All the management proposals were carried (and only two with **sub-90%** approval rates), whereas the shareholder proposals were not – largely because the management proposals or incumbent strategies and disclosure are already commensurate with the shareholder proposals.

The least supported proposal from management triggered dissent because, *although considered a positive step*, it was deemed materially insufficient to "meet the Paris targets", along with an absence of absolute targets, and reliance on nature-based solutions and Carbon Capture and Storage (CCS).

TOWARDS MORE AUTONOMY ON SUBSIDIARY BOARDS[1]

Recent money laundering cases at Danske Bank, HSBC,[2] Standard Chartered,[3] Swedbank[4] and many other financial groups have brought the importance of sound group oversight to the attention of shareholders. These cases were primarily linked to the operations and business activities of the banking groups' international branches and subsidiaries. The consequence has been fines, that in some cases amount to billions and can result in a significant negative reputational impact. Shareholders' potential liability for the acts of subsidiaries and the potential reputational impact provide a strong reason for them to care about group governance. Regulators also have a high interest in ensuring financial group governance arrangements are appropriately structured. These concerns, in addition to ensuring effectiveness and continuity of decision making, are key drivers behind some of the advice sought by Nestor Advisors' clients.

Subsidiary board composition is a key tool for parent oversight of their subsidiaries. The following article shows how growing regulatory expectations in Europe regarding banking subsidiary independence levels (driven by increasing regulatory pressures in financial conglomerates to clearly separate their risky operations from the deposit taking part of their businesses) and their enhanced responsibilities are driving an increase in the autonomy of subsidiary boards in Europe. To demonstrate some of the points, we use subsidiary board composition trends among 14 leading European banks[5] which areregularly collected by Nestor Advisors.

Subsidiary board composition serves as an important coordination mechanism between parent company boards and subsidiary boards in groups.

The profile of subsidiary boards is driven by many internal and external factors. Some of these factors include the parent company's objective and funding strategy, the market environment that the parent and subsidiary operate in, as well as historic contextual and legacy factors. External pressures also play a key role in this regard, as addressed further down.

Parent non-executive directors (NEDs)[6] or parent executives sitting on subsidiary boards constitutes a good coordination mechanism between group-level boards and their subsidiary equivalent.[7,8] In particular, parent NEDs create the interface between the parent board and subsidiary boards, allowing for fluid information flows and group cohesion. Parent executives keep the group executive informed and can provide in-depth knowledge of operational matters.[9] These are powerful reasons to populate subsidiary boards with parent board

1. For an in-depth discussion about these topics please check Point of View – Group governance: a pocket primer for financial groups https://www.nestoradvisors.com/var/files/pdf/PoV/PoV006.pdf
2. Money-laundering ring pushed $4billion through HSBC — The Bureau of Investigative Journalism (en-GB) (thebureauinvestigates.com)
3. Standard Chartered Bank's Long History Of Financial Crime (forbes.com)
4. https://www.moneylaunderingnews.com/2020/03/aml-problems-plague-swedbank/
5. Parent companies considered include: Banco Santander SA, Barclays PLC, BNP Paribas SA, BPCE SA group, Crédit Agricole SA, Deutsche Bank AG, ING Groep NV, HSBC Holdings plc, Nordea Bank Abp, NatWest Group, Société Générale SA, Standard Chartered PLC, UBS Group AG, UniCredit SpA. Information was collected from publicly available annual reports. We note that information for UBS Switzerland AG could not be located.
6. Parent NEDs: Serve on both the subsidiary board and the parent board. No executive connection.
   Parent executives: Have executive responsibilities at group level or in other legal entities, and sit on the board as (non-independent) non-executive directors.
   Subsidiary executives: Have executive responsibilities in the subsidiary, but no executive responsibilities at the parent company. They may hold additional executive positions within other subsidiary companies.
7. Group coordination officers, group policies (on different topics, risk, finance), service level agreements, group executive/management committee, board away-days, secretariat coordination, board presentations by business functions and subsidiaries.
8. Other forms of coordination are group-coordination officers, group policies, service level agreements, group executive/management committee, board away-days, secretariat coordination, board presentations by business functions and subsidiaries.
9. In addition to direct parent oversight, major subsidiaries are sometimes entrusted with the oversight of less significant subsidiaries, in a multi-level hierarchy. In this scenario, less significant business lines are supervised by major subsidiary board members, by sitting on the boards of the less significant subsidiaries. This introduces a new dimension to the traditional parent/subsidiary tension, by adding a layer in the structure and intermediating the interaction between the apex and the bottom of the corporate hierarchy.

members – reducing informational asymmetries and sharing expertise are among the principal justifications. However, excessive parent board participation in multiple subsidiaries may overburden NEDs and undermine the accountability of subsidiary senior management.[10]

The presence of parent NEDs and executives on subsidiary boards are usually complemented by subsidiary-only NEDs[11] and subsidiary executives. While subsidiary NEDs provide an independent critical view, the presence of subsidiary executives ensures their accountability, as they answer to the board and share the same liability, and a more informed decision-making process.

Increasing regulatory expectations on subsidiary directors' independence and banking subsidiary responsibilities are driving a shift in subsidiary board composition.

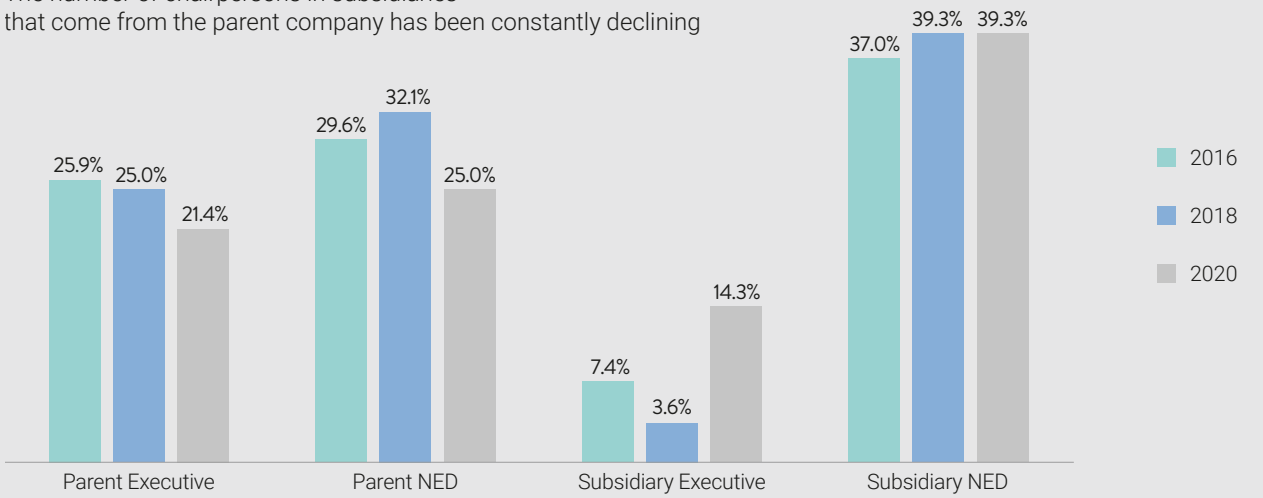
Company subsidiaries are increasingly being faced with stricter supervisory expectations, particularly on the level of autonomy subsidiaries are to have. As shown below, **increased requirements on banking subsidiaries' responsibilities and independence levels have resulted in an increased presence of "subsidiary NEDs" on subsidiary boards.**

In terms of independence, **countries are embedding board independence requirements within their regulations, corporate governance codes and sometimes even laws**. The 2021 OECD Corporate Governance Factbook found that nearly all (92%) of OECD, G20 and Financial Stability Board ("FSB") member jurisdictions require or recommend a minimum number or ratio of independent directors. In the case of the UK, the Prudential Regulation Authority ("PRA") particularly stresses the importance of having a substantial independent presence even in subsidiary boards.[12] Definitions of independent directors have also become stricter in recent years: 80% of OECD, G20 and FSB member jurisdictions now require directors to be independent of significant shareholders to be classified as independent, up from 64% in 2015.[13]

The role of the chairperson is especially scrutinized. Some supervisors, such as the PRA, consider it *"generally undesirable"* that key positions on the board of a subsidiary, such as the chair and chairs of the key board subsidiary committees be occupied by executive members of the group or from the parent board. This is in line with the expectation that subsidiary boards should not be a mirror image of the parent company board or executive team.[14] For instance, in France, it is a legal requirement that the board

TYPE OF CHAIRPERSONS ON SUBSIDIARY BOARDS

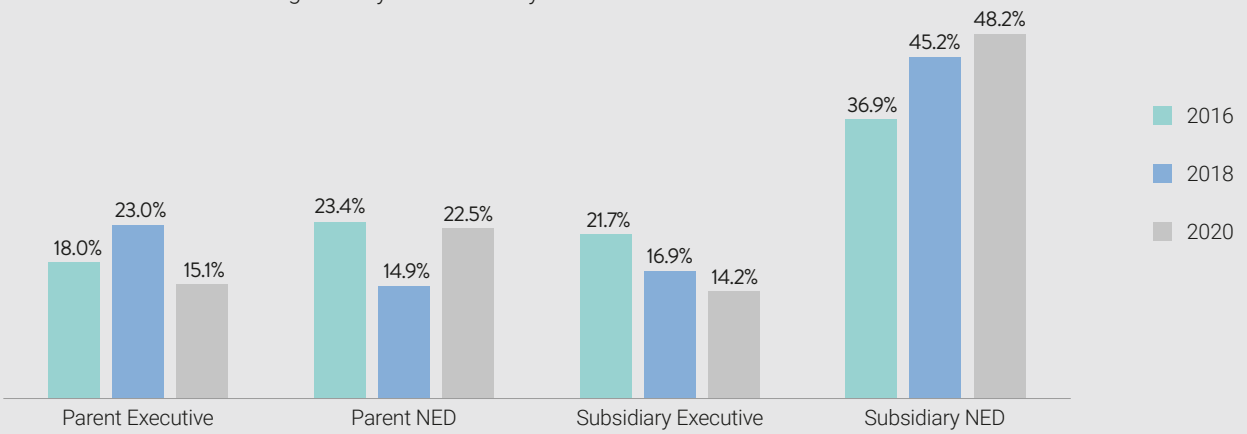
The number of chairpersons in subsidiaries
that come from the parent company has been constantly declining



10. The ISS (for the UK & Ireland) currently recommends that any NED that does not hold executive or chairmanship positions may hold up to four other non-executive directorships (ISS Governance Policy, Director Overboarding (UK & Ireland) [Available online: https://www.issgovernance.com/file/policy/uk-ire-overboarding.pdf]).
11. Subsidiary NEDs: Do not serve as NEDs on the board of the parent company and are not executives in any group entity. However, they may serve as NEDs elsewhere within the group.
12. PRA - Supervisory Statement 5/16 - July 2018.
13. OECD (2020), "OECD Corporate Governance Factbook 2021", https://www.oecd.org/corporate/corporate-governance-factbook.htm.
14. Strafford, Corporate Governance of Subsidiaries: Emerging Risks and Best Practices: presentation.pdf (straffordpub.com).

TYPE OF DIRECTORS ON SUBSIDIARY BOARDS

Subsidiary NEDs are the prevalent type of directors on subsidiary boards, with their number increasing steadily between the years of 2016-2020



members of the parent and the subsidiary be different.[15] This explains why subsidiary chairs are mostly subsidiary NEDs, with a decreasing number of parent NEDs and executives occupying this role (see graph above).

A push for subsidiary autonomy has been underway for some time. In 2012, the Basel Committee on Banking Supervision ("BCBS") called for supervisors to require that members of the boards of its significant subsidiaries act independently of the wider group. In a subsequent publication in 2014, the BCBS also clearly stated that *the board of a* ***regulated subsidiary of a banking group is to retain and set its own corporate governance responsibilities and practices*** *in line with its own legal requirements or in proportion to its size or business.*[16] It is subsidiary boards and senior management that remain responsible for developing effective risk management processes for their entities.[17]

Parent companies should ensure that adequate tools and authorities are available to the subsidiary and that the subsidiary understands the reporting obligations it has to the head office.[18]

In the UK, the law required the largest UK banks to separate core retail banking services from their investment and international banking activities by 1 January 2019. This is known as ring-fencing. It is required that the ring-fenced body be able to make decisions independently from the other group companies and that it does not depend on resources provided by them.[19] Additionally, if a parent company engages in the direct management of its subsidiaries, the parent company may be liable to external parties and in some cases to the subsidiary.[20] This "piercing of the corporate veil" has been confirmed in the UK by recent case law, which indicates that the extent to which the parent takes over or shares management of the relevant subsidiary is a key determinant on parent liability for the acts of the subsidiary.[21]

In summary, increasing regulatory expectations on independence levels and responsibilities of banking subsidiaries in Europe are driving an increase in their autonomy and making subsidiary NEDs the prevalent board members and board chairs of subsidiary boards.

15. Law no. 2013-672 du 26 juillet 2013 de separation et de regulation des activites bancaires, J.O. n°173 du 27 juillet 2013, p. 12530.
16. Basel Committee on Banking Supervision, Principles for the supervision of financial conglomerates, September 2012, p. 23.
17. Basel Committee on Banking Supervision, Guidelines – Corporate governance principles for banks, July 2015, p. 23.
18. Basel Committee on Banking Supervision, Guidelines – Corporate governance principles for banks, July 2015, p. 23.
19. Lehmann, M. (2016). Volcker rule, ring-fencing or separation of bank activities–Comparison of structural reform acts around the world. Journal of Banking Regulation, 17(3), 176-187.
20. The governance of company groups – OECD 2021.
21. Facing up to responsibility: Parent liability for overseas subsidiary actions in the English courts, April 2021: Facing up to responsibility: Parent liability for overseas subsidiary actions in the English courts (shlegal.com).

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