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2024 Annual Reporting Season: Key Considerations

October 2023

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Planning for the 2024 annual reporting season is underway. We summarise the key legislative changes affecting London-listed companies for the upcoming season along with best practice recommendations.

1. Disclosure of Board Diversity – new legislation

For companies with a 31 December financial year end, the annual report they publish in 2024 (for the FY 2023 financial period) will be the first time they have to report on the new Listing Rule diversity targets. Companies which have not voluntarily made these disclosures in 2023 will need to ensure they are in a position to make such disclosures next year.

In April 2022, the Financial Conduct Authority ("**FCA**") published its Policy Statement[1] on diversity and inclusion for company boards and executive management. The new rules apply to certain listed companies for the financial years starting from 1 April 2022. From this date, the Listing Rules require certain companies with a premium listing or standard listing (whether shares or depositary receipts) to include in their annual reports:

- a "comply or explain statement" describing whether they have achieved certain specified targets for women and ethnic minority representation on their board[2]; and
- a standardised numerical disclosure on the ethnic background and gender identity or sex of their board, key board positions and executive management team.[3]

Such listed companies must also explain their approach to collating diversity data to meet these disclosure requirements, including the method, source, whether this has been collated by self-reporting and, if it has, a description of the questions asked.

In Primary Market Bulletin 44[4], the FCA makes it clear that its supervisory role includes conducting periodic reviews of annual reports to determine whether listed companies are meeting the diversity disclosure requirements and that companies may be asked to take "corrective action" if their disclosures do not appear to meet the requirements, including requesting that the company publishes information via a RIS. The FCA goes on to say that "*any non-compliance will be viewed seriously and will lead to action using [its] full suite of powers*".

[1] See FCA's Policy Statement PS22/3 entitled 'Diversity and inclusion on company boards and executive management', available here.

[2] LR 9.8.6R(9) for premium listed issuers and LR 14.3.33R(1) for standard listed issuers. LR18.4.3R(2) extends certain provisions of LR 14.3 (including LR 14.3.33R) to standard listed issuers of depositary receipts.

[3] LR 9.8.6R(10) for premium listed issuers and LR 14.3.33R(2) for standard listed issuers.

[4] See Primary Market Bulletin 44, available here.

Companies should review their governance arrangements for oversight of diversity and inclusion targets and reporting and take any necessary steps to enhance internal procedures, systems and controls, being mindful of their broader obligations under Listing Principle 1.

For further information, please see our recent publication entitled 'Diversity on UK Boards'.

2. Climate-Related Disclosures – new best practice guidance

In July 2023, the Financial Reporting Council ("**FRC**") published its Thematic Review of 20 UK premium and standard listed companies and their compliance with the Task Force on Climate-Related Financial Disclosures ("**TCFD**") framework. The review sets out useful guidance for best practice reporting for companies and emphasises the need for companies to focus on explaining their chosen targets as well as their actions and the impact of these on their financial statements.

The findings also set out the FRC's expectations moving forward with regards to better disclosure and reporting in upcoming annual reports, which include:

- clear explanations of what 'net zero' or 'carbon neutrality' means to the company and ensuring that any disclosures about such commitments are not misleading;
- the definition and reporting of company-specific metrics and targets, beyond headline 'net zero' statements;
- the explanation of year-on-year movements in metrics and performance against targets;
- transparency about internal carbon prices, where used by companies to incentivise emission reduction;
- better linkage between climate-related targets reported in TCFD disclosures and ESG targets disclosed in the Directors' Remuneration Report;
- explanations of targets including relevant information such as time-period, reporting boundaries and metrics used to measure emissions scopes covered;
- explanations as to areas of significant challenges or uncertainties in the context of meeting such targets; and
- explanations as to whether carbon offsetting represents a significant part of a company's strategy to reach net zero.

The FRC concludes that many companies are struggling to present a clear message to investors about which metrics and targets are materially important for managing climate-related risks and opportunities and their transition plans. Companies are reminded of the '4Cs' of effective corporate communication: company-specific; clear, concise and understandable; clutter free and relevant; and comparable.

Companies should consider the appropriate level of detail to be included in their climate-related financial disclosures and take into account the level of the company's exposure to climate-related risks and opportunities, as well as the scope and objectives of their climate-related strategy. Companies should also endeavour to show how they have progressed over time towards their chosen climate-related targets. When preparing their TCFD disclosures, companies should take account of the FRC's guidance.

Mandatory "comply or explain" reporting against the TCFD framework has been a requirement under the Listing Rules in relation to financial years beginning on or after 1 January 2021 (for premium listed issuers) and 1 January 2022 (for issuers of standard listed shares or depositary receipts). UK incorporated traded companies must also report against a variant of the TCFD framework pursuant to the requirements of the Companies (Strategic Report) (Climate-related

Financial Disclosure) Regulations 2022[5] ("**CRFD Regulations**"), which apply for financial years beginning on or after 1 April 2022.

While the Listing Rules and accompanying guidance (which directly reference the TCFD's recommendations, recommended disclosures and specified TCFD-published guidance materials) and the CRFD Regulations (which do not) cover the same substantive areas, companies should be aware that there are some wording differences between them. Non-binding guidance issued by the Government[6] notes that "*where a UK-registered listed company is subject to both sets of requirements, disclosure in a manner consistent with all of the TCFD recommendations and recommended disclosures for the purposes of the FCA's listing rule in its annual report is likely to involve use of similar information to the disclosures required by these regulations; therefore, it is normally likely to meet the requirements of [the CRFD Regulations]*". Note that this guidance is not definitive ("normally likely") and is limited to companies which fully comply (rather than explaining non-compliance) with all of the TCFD recommendations and recommended disclosures. For companies with a 31 December year end, this will be the first year of mandatory reporting against the CRFD Regulations, so they will need to ensure that appropriate disclosures are made.

See the FRC's '*CRR Thematic review of climate-related metrics and targets'*, published July 2023, available here.

3. Executive Remuneration

We expect to see a wave of remuneration policies up for approval over the course of the 2024 reporting year as the three-year approval cycle comes round again. Remuneration policies continue to be among the most heavily contested at AGMs, with two resolutions to approve FTSE 350 remuneration reports voted down so far in 2023. For 2024, companies should ensure they are actively engaging with shareholders with regards to their remuneration proposals in advance of circulating their AGM notice.

In its 2023 Principles of Remuneration, the Investment Association ("**IA**") stated that given the difficult external environment, companies will be expected to show restraint as to pay increases, and any increases should be carefully justified. The IA also expects pension contributions for executives to be aligned with the majority of the company's workforce (reflecting Provision 38 of the current UK Corporate Governance Code ("**UK CGC**")). Whilst this provision was first added to the UK CGC in 2018, this is an area where a number of companies are still not in compliance. Given the amount of time companies have had to become aligned with the UK CGC, disclosure against this Provision may be met with questions from shareholders and proxy advisors.

The FRC has also indicated their expectations for the Directors' Remuneration Report, and will require the report to clearly describe climate-related targets and actual achievements against them, in a manner consistent with the TCFD disclosures.[7]

4. Assurance, integrity of reporting and greenwashing

With the continued spotlight on companies' ESG and sustainability policies, and investors rightly looking to scrutinise the underlying ESG data, companies must be especially cognisant of the perils of 'greenwashing' the ESG claims made in their annual reports. There have been several high-profile examples in 2023 of publicly listed companies falling foul of greenwashing claims. Companies should ensure that all statements and claims can be robustly verified. This should also be considered against the backdrop of the FRC's proposed changes to the UK CGC – see below – and the proposal to make the audit committee responsible for "*monitoring the integrity of narrative reporting, including sustainability matters, and reviewing any significant reporting judgements*".

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5 The CRFD Regulations most notably added sections 414CB(A1), (2A), (4A) and (4B) to Companies Act 2006.

6 "Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs", available here.

7 See page 77 of FRC's '*CRR Thematic review of climate-related metrics and targets'*, published July 2023, available here.

Whether or not the proposed changes actually make their way into the UK CGC, companies should reassess the internal processes they go through to provide assurance about the integrity of their narrative reporting, including which internal stakeholders take responsibility for which sections of the annual report, how these sections are verified and the retention of the verification materials.

Whilst the narrative part of the annual report is not audited, the auditors are required to identify any material inconsistences with the audited information in the financial statements. In our experience, law firms (and auditors) are increasingly being instructed to undertake a technical review of the narrative information in annual reports to help ensure compliance with relevant laws and guidance, as well as to interrogate and verify the information provided.

5. Ongoing Developments – Corporate Governance Reforms

Whilst we are yet to see what the final revised UK CGC will look like following the closing of the FRC's consultation on 13 September 2023 ("**UK CGC Consultation**"), the consultation process has provided a reminder of some of the key themes on which the FRC is focused (communicated through previous FRC Lab reports and best practice guidance) and which companies should bear in mind, in particular:

Outcomes-based reporting: In recent years, the FRC has repeatedly emphasised the need for companies to provide better explanations through outcomes-based reporting. In the FRC's Annual Review of Corporate Governance Reporting published in November 2022, they noted that it is no longer sufficient to simply state the company's commitments and internal procedures; narratives must *explain* and provide evidence of specific activities and the outcomes of these. They note that better quality annual reports will give an overview of the scale of activities and specific initiatives taken throughout the reporting year, include specific examples and case studies, and demonstrate how progress has been made in the reporting year towards the overall outcome, compared to previous years.

Overboarding: A further area which continues to be scrutinised by the FRC and proxy advisors is the number and nature of directorships a director can hold. The FRC in their UK CGC Consultation have proposed additional disclosure around "*how each director has sufficient time to undertake their role in light of commitments to other organisations*" and "*all significant director appointments*" listed in the annual report. Whilst further guidance is needed around exactly what disclosures will be required, companies will be well placed in fully understanding the commitments of their directors (and any proposed new appointments) ahead of any new "comply or explain" disclosure requirements and assessments so that there are no surprises. This process may be best handled as part of the annual conflict of interest declarations refresh that many companies undertake.

ESG and remuneration: At the start of the year, WTW[8] reported that the occurrence of ESG-linked goals appears in both short-term and long-term payment plans in the UK. According to their study, 85% of UK PLCs tied their short-term pay packages to at least one ESG measure, up from 79% in the previous year. The proposed revisions to the UK CGC will require companies to say that remuneration of their executives will be tied (in part) to ESG outcomes. Companies and their Remuneration Committees should consider the extent to which such linkages are already in existence and the extent to which they are appropriate for the business in question.

6. Adoption of PEG Guidelines

In November 2022, the Pre-Emption Group ("**PEG**") issued revised guidance on the disapplication of pre-emption rights based on the UK Secondary Capital Raising Review's recommendations.

In our September 2023 AGM Snapshot (available here), we noted that only 41% of FTSE 350 companies which issued their AGM notices between November 2022 and the end of August 2023 had adopted the new PEG guidelines to some extent. Moreover, 9% had adopted the 10% + 10%

8 See WTW Press Release entitled, 'ESG measures in executive incentive plans gaining momentum', available here.

thresholds, but decided not to take authority for related follow-on offers. Whilst it is unclear what the rationale for this is, it may be because companies that issue (over a 12 month period) shares representing 20% or more of those already admitted to listing must generally publish a prospectus.

Companies considering adopting the new PEG guidelines should continue to monitor market practice. Of interest, Glass Lewis have published a blog that provides background on the changes to best practice guidance for the disapplication of pre-emption rights, insights into the impact of these changes on recent voting outcomes and a consideration of the narratives behind increased instances of significant shareholder opposition.

For more information, please see our publication entitled 'FTSE 350: September 2023 Snapshot of Arrangements for AGMs' and the Glass Lewis blog here.

7. How to hold your AGM.

As noted in our September 2023 AGM Snapshot (available here), the trend of companies holding their AGMs entirely physically continues to increase with 62% of FTSE 350 companies opting out of any form of electronic engagement. Fewer meetings (19%) are being held as hybrid meetings (25% 2022) and only 2 companies (TUI AG and Clarkson PLC) have held a fully virtual meeting.

We do not anticipate this trend changing in 2024.

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