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Via email: **codereview@frc.org.uk**

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RE: BCI Response to the Proposed Revision of the UK Corporate Governance Code

We welcome the opportunity to respond to the consultation on the proposed revisions to the UK Corporate Governance Code.

With CAD$233 billion of gross assets under management, British Columbia Investment Management Corporation (BCI) is a leading provider of investment management services for British Columbia's public sector and one of the largest asset managers in Canada. Investment returns play a significant role in helping our institutional clients build a financially secure future for their beneficiaries. As our clients have obligations that extend beyond 70 years, we take a long-term view on our investments. BCI relies on well-functioning capital markets, and we consider it our responsibility to contribute to the overall stability of the financial system.

As an active participant in the capital markets, we address systemic risks with the expectation that our efforts will lead to greater stability and integrity within the markets. We regularly engage with regulators and advocate for legal and regulatory changes to ensure that principles of good governance are integrated into the regulatory framework. As such, we appreciate the opportunity to respond to the proposed revisions to the UK Corporate Governance Code ("the Code").

As the first jurisdiction to publish both a Corporate Governance Code and a Stewardship Code, the UK has demonstrated leadership in this area. Directionally speaking, BCI is supportive of the proposed revisions, which, in our view, continue to demonstrate leadership by increasing the effectiveness of corporate governance practices especially as they relate to effective risk management and internal controls as well as the wider responsibilities of the board and audit committee to report on environmental, social and governance (ESG) factors. In addition to expressing our broad support for the direction of the Code, we would like to draw attention to some specific areas of interest for BCI.

Section 1 – Board leadership and company purpose

Question 1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

BCI response: We agree with the effort to focus on outcomes in this principle as it will encourage firms to move away from using boilerplate language. We encourage inclusion of examples of best practice (e.g., in the FRC's *2022 Review of Corporate Governance Reporting* leading companies provided specific examples and case studies), which could be provided in the provisions section to facilitate adoption of this important focus. When relevant, we believe it is useful to adopt quantitative indicators that can demonstrate outcomes. This could reduce disclosure burdens on firms as they would provide more focused narrative disclosures to explain the quantitative trends. As part of our investment decision-making, we encourage companies to focus disclosures on material, industry-level factors as described by SASB and now ISSB. Investors benefit from having timely, high-quality and comparable data across all aspects of a firm's material activities.

Question 2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

<u>BCI response</u>: We fully agree with the framing of Provision 1 and the addition of environmental and social factors, including climate ambitions and transition planning. Linking these to implementing a firm's strategy is key for most industries, and we believe disclosures aligned with TCFD recommendations can help firms articulate the governance oversight of environmental factors in a widely adopted format preferred by many global investors. We encourage the inclusion of examples of voluntary standards and reporting frameworks in the provisions and would strongly suggest prioritizing the ISSB standards here. The ISSB standards provide a global baseline and represent a common starting point for sustainability reporting which can be built upon in the future.

Expectations are rising among investors for climate change oversight by boards and this resulted in several votes at UK companies either against directors or for climate-related shareholder proposals this past proxy season. BCI voted against directors or in support of climate-related shareholder proposals at four UK companies due to their insufficient disclosures and/or performance on climate change. Globally, we voted against 149 directors for these same reasons and will be following up with a number of these companies to engage with them on these issues.

Question 3: Do you have any comments on the other changes proposed to Section 1?

<u>BCI response</u>: We are concerned that the meaning of some terms, such as 'climate ambitions' and 'sustainability' are not clearly defined in the Code. For the term, 'climate ambitions', it is unclear what exactly it refers to. Is it ambition to reduce and manage climate risk or is it about finding climate-related opportunities, or both? To put a finer point on this, we believe it would be beneficial to clearly state in Provision 1 that the board has a responsibility to oversee and report on the effectiveness of management's approach to climate change related risks and opportunities. For the latter term, we infer a meaning of financial sustainability or resilience under principle A while the usage in Provision 1 could be interpreted as environmental sustainability. Since a financially sustainable business model could be environmentally and socially unsustainable, we suggest development of a glossary to ensure users of the Code have a consistent understanding of the key terms used in the principles and provisions.

Section 2 – Division of responsibilities

Question 4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

<u>BCI response</u>: We agree with changes to section 3 on making such commitments part of the board performance reviews.

Question 5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

BCI response: We agree with the proposed change and expect it would encourage adequate disclosures of directors' significant external commitments, although there appears to be some duplication that could be streamlined in this provision.

Section 3 – Composition, succession and evaluation

Diversity and inclusion

Question 6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

BCI response: The various revisions related to diversity and inclusion appear aligned with the 2022 FCA listing rules and guidance. Given the prominent gender target under the 2022 FCA listing rules, we believe referencing it would help provide reinforcement for that target even if it is duplicative. BCI is a member of the 30 per cent Club Canada and our proxy guidelines hold nomination committees accountable when female representation is below 30% unless a company has a clear policy, target and timeline. From 2022, we began holding nomination committees accountable across select indexes within the US when there is not at least one racially or ethnically diverse director. We have since expanded the guideline to Canada's TSX composite index and expect to continue expanding it to other markets as data quality improves. As a result, we generally support the Code's proposed improvements.

Question 7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

BCI response: We support the consideration of diversity more broadly, and feel the new language, could be complemented by providing a definition of protected/non-protected characteristics for clarity's sake. We also see an opportunity to add in a reference to equity given that the common terminology is now diversity, equity and inclusion (DEI). To more directly link Principle I to Provision 24, we suggest including reference to diversity objectives found in Provision 24.

Question 8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

BCI response: We believe the work of the nomination committee should be more transparent with the suggested changes to Provision 24.

Board performance reviews

Question 9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

BCI response: We are in general agreement with the wording changes in Provision 22 that reflect the CGI recommendations, and we strongly support the wording change from 'consider having' to 'commission' a regular external review. BCI believes that a robust and comprehensive board evaluation or performance review process is fundamental in ensuring that the board is operating effectively. We also believe that the periodic use of an external firm to conduct the review can be very beneficial to the overall effectiveness of the board. We see the external perspective that comes from this as a crucial check for boards, and believe it outweighs the potential cost. In our view, an independent board performance review should be complementary to internally led reviews, and we see the benefits of such an approach applying to all companies and encourage the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years. We also agree that externally led reviews could be focused on continuous improvement, but we believe internally led reviews should be an objective accountability mechanism that could lead to significant changes up to and including the removal of a director. We see an opportunity to clarify the distinctions between the parameters and objectives of the annual internal reviews and the triennial external reviews in Provision 22.

Section 4 – Audit, risk and internal control

Audit and Assurance Policy

Question 10: Do you agree that all Code companies should prepare an Audit and Assurance Policy (AAP), on a 'comply or explain' basis?

BCI response: We agree with the proposal that all Code companies prepare an AAP on a 'comply or explain' basis. Given the pending regulations and draft legislation related to the content and applicability of an AAP, the new references in Provisions 26 & 27 are appropriate and consistent with the overall Code's 'comply or explain' approach. We also agree with the proposal to task the audit committee with the responsibility to develop the AAP and the expectation the committee would engage the entire board as part of the process. We also agree that the requirement to produce an AAP should not be limited to Public Interest Entities (PIEs). The need for quality sustainability data and the new standards issued by ISSB provide a good opportunity for the Code to encourage all companies to adopt robust assurance policies. Bringing audit and assurance together is also a key opportunity to bring climate risks into the audit function as described in Provision 29, although we suggest providing specific examples of emerging risks, including physical risk from climate change.

Audit Committees and the External Audit: Minimum Standard

Question 11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

BCI response: We agree with the changes to remove duplication and refer companies to the minimum standard for audit committees.

Sustainability reporting

Question 12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

BCI response: Given the important risk oversight role of audit committees and the current and growing impacts of climate change, we fully support the expansion of the audit committee's remit. We also agree that stand-alone sustainability committees need not be prescribed in the Code given the various ways sustainability and ESG factors are managed by the board. BCI generally defers to the board and its judgement to develop the appropriate committee structure. We do see value in the FRC providing additional guidance in the Provisions to provide suggestions such as following the TCFD framework, which is complementary to other markets' disclosure requirements, and the newly released ISSB standards.

Overall, we believe the direction of travel is for material sustainability factors to eventually move beyond assurance of data quality to full integration within financial statements and subject to the rigours of an external audit, and the current proposals to update the Code are in line with supporting that eventual transition. To expedite this transition in the US and Canadian markets, BCI filed shareholder proposals at Exxon Mobil Corp. and Imperial Oil Ltd., asking for an audited report estimating the quantitative impacts of the IEA Net Zero Emissions scenario on all asset retirement obligations. The support levels for these proposals were in line with our expectations at 16% at Exxon and 18.9% at Imperial (excluding Exxon's controlling shares). We believe this illustrates emerging interest and consideration from investors on this topic.

Risk management and internal controls

Question 13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

<u>BCI response</u>: We support the combination of Principles C and O to require additional responsibility for the board to not just establish but also maintain the effectiveness of the risk management and internal control framework. While we agree with the FRC's approach of not prescribing the need to report on the board's intent to obtain external assurance over the firm's risk management and internal control framework, we strongly encourage the FRC to provide substantive guidance for companies in developing their AAP not only for the risk management and internal control framework but also for material sustainability information.

Question 14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

<u>BCI response</u>: Due to the risks of possible restatements after the date of the balance sheet, we believe it is prudent for the board's declaration to be made for the period up to the date of the annual report. This would reduce reputational risk for the board and company as any restatements could indicate potential weaknesses in internal controls that would be perceived by the market as an oversight failure by the board. BCI routinely holds audit committee members responsible for oversight failures related to material restatements in our proxy voting.

Question 15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

<u>BCI response</u>: Given the relevance of material sustainability information in our investment decision-making, we believe it is advisable to change 'financial' to 'reporting' to capture controls on both narrative and financial reporting. As noted earlier, the direction of travel is toward integrating the reporting of sustainability factors and financials and the proposed modifications align with that trend.

Question 16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

<u>BCI response</u>: As noted above, BCI encourages the FRC to provide substantive guidance on commonly used methodologies or frameworks. In our experience, companies frequently request guidance on what we see as best practice frameworks and standards for reporting out material sustainability information,

so the more detailed the guidance is, the more benefit companies and their stakeholders are likely to receive.

Question 17: Do you have any proposals regarding the definitional issues, e.g., what constitutes an effective risk management and internal controls system or a material weakness?

BCI response: We find the proposed definition of material weakness and the sources used are appropriate.

Question 18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

BCI response: We recognize the need to place the responsibility of material risk assessments on the board and avoid prescribing what is or is not deemed material. However, we believe additional guidance either in the provisions or in the forthcoming update to the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, should include specific examples of emerging risks such as climate change risk and related operational risks such as physical or transition risk.

Section 5 – Remuneration

Changes to strengthen links to overall corporate performance

Question 22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

BCI response: The expansion of performance to now include ESG objectives is a welcome addition, but we encourage the FRC to provide guidance on how to develop and disclose rigorous, quantitative ESG metrics whenever possible as we still lack clear disclosure and observe poorly defined ESG metrics in remuneration plans, indicating a potential overreliance on remuneration committee discretion.

Malus and clawback

Question 23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

BCI response: We believe the proposed changes will improve transparency and we find the inclusion of the suggestion that companies set out how they used the provisions in the last five years as particularly effective.

Changes to improve the quality of reporting

Question 24: Do you agree with the proposed changes to Provisions 40 and 41?

BCI response: We support most of the proposed revisions to Provision 41 and believe the simplified version of Provision 40 in the new Provision 34 will continue to offer practical principles of remuneration design that we regularly emphasize in engagement with companies. We suggest providing some examples of how to identify and mitigate the key risks associated with remuneration such as how to avoid excessive risk taking. We also see an opportunity to provide additional guidance in Provision 43 on the importance of engaging with shareholders on remuneration, especially when voting support for the remuneration policy or report drops significantly. Generally, we expect remuneration committee disclosure on shareholder engagement when support drops below 80%. In our approach to voting on remuneration, we would be concerned if there is a lack of board engagement and improvement in the structure or design after a significant drop in support levels, which could result in us continuing to vote against remuneration policies and reports, and we may escalate to voting against committee members.

Question 25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

BCI response: We encourage retention of reference to pay gaps and pay ratios as we believe executive pay needs to be linked to the outcomes for the broader company workforce as one way to address income inequality. We believe remuneration committees should be expected to demonstrate to the wider workforce, as well as shareholders, how pay and incentives align across the company, and how decisions over executive pay are consistent with the company's wider pay policy. While investors are unlikely to use these metrics for investment or voting decisions in isolation, pay gaps and pay ratios serve as a reference point and aid investors in contextualizing a company's pay structure and decisions.

Artificial intelligence

Question 26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

BCI response: Given the UK Government's intent to promote AI innovation through agile regulation, it may be appropriate for the Code to reference the five cross-sectoral principles and encourage boards to provide an "AI Statement" that speaks to the board's role in the oversight of management's strategy and approach to AI-related risks and opportunities. As AI policies become more common, the Code could provide basic suggestions on how boards should clarify the governance over the development of such policies, which may overlap with cybersecurity and data privacy policies.

Concluding remarks

Overall, we reiterate our support for the direction that the FRC is taking with the proposed revisions to the Code. We believe implementation of the proposals will strengthen the Code and increase effectiveness of corporate governance practices in the UK by addressing risk management, internal controls and outlining the responsibilities of the board and audit committee to address ESG factors.

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