GLASS LEWIS

UK Corporate Governance Code Consultation

September 2023

To: Code Review, Financial Reporting Council ("FRC")

Re: Corporate Governance Code Consultation

Glass, Lewis & Co. ("Glass Lewis") appreciates the opportunity to comment on the consultation regarding proposed amendments to the UK Corporate Governance Code (the "Code"), which commenced in May 2023.

About Glass Lewis

Glass Lewis is the leading global provider of research and corporate governance solutions with a client base of more than 1,300 clients, including the majority of the world's largest pension plans, mutual funds and asset managers, who collectively manage more than $40 trillion in assets. Glass Lewis empowers institutional investors to make sound voting decisions at more than 30,000 meetings each year by analysing and assessing corporate governance and material environmental and social risks at public companies domiciled in approximately 100 global markets. We provide comprehensive research for all listed companies held in our clients' portfolios. In 2020, this universe included approximately 16,000 global public companies. More information available at www.glasslewis.com.

While Glass Lewis is registered with the FCA as a proxy advisor, a signatory to both the UK Stewardship Code and the BPP Group, Glass Lewis is submitting this comment as an interested industry advisor and not on behalf of any of its clients.

Glass Lewis' Views on the Proposal

We are mindful that the proposed amendments to the Code are intended to adopt new guidance in relation to the UK government's white paper on 'Restoring trust in audit and corporate governance' as well as to incorporate the outcomes of certain initiatives that the FRC has been working on recently. Accordingly, our feedback is solely focused on the proposed amendments, rather than general comments or suggestions for further development of the Code. Furthermore, our comments are limited to the consultation questions on which we believe that our expertise and unique position in the proxy voting chain is additive to the discussion.

In the aggregate, we welcome the proposed changes to reporting requirements which appear focussed on increased clarity and transparency; we are cautiously optimistic that these should serve to further encourage a move away from perfunctory/boilerplate language. Glass Lewis relies on publicly disclosed information to inform our analysis and concomitant recommendations. As such, increased transparency in reporting will facilitate greater contextualisation in the application of our 'principles-based' policy guidelines.

We aim to take a holistic approach to each company's governance practices, and therefore welcome an enhanced description where a company opts to 'explain' its deviation from the Code rather than 'comply'. We are hopeful that the proposed changes will lead to more meaningful insights into board discussions, decisions, and outcomes.

Section 1 – Board Leadership & Company Purpose

Q1. Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcome-based reporting?

While the proposed amendments to Principle D would inevitably lead to an increased focus on reporting on the outcomes of governance activity, absent the provision of a reporting template or guidance on outcome-based reporting, we believe it is too early to comment on the extent to which the proposed changes will lead to more meaningful outcome-based reporting.

We understand and support the FRC's general non-prescriptive approach, which provides flexibility to corporate issuers to interpret and apply the Code's principles. We also believe that the boards of UK-listed companies will have some familiarity with outcome-based reporting from the reporting of asset managers, asset owners, and service providers under the Stewardship Code. Nevertheless, we strongly believe that this is an area in which clear guidance is essential to ensure that this proposed change will encourage more meaningful and insightful reporting practices, increased transparency, and reduced boilerplate language, resulting in increased accountability and ability to demonstrate how the board's strategies and decision-making are creating value for shareholders.

Q2. 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?

We agree that boards should report on climate ambitions and transition in the context of strategy and governance.

Glass Lewis generally believes that companies materially exposed to climate risk stemming from their own operations should clearly articulate their climate plans in a distinct and easily understandable document, which, as a best practice, should generally be aligned with the recommendations of the Task force on Climate-related Financial Disclosures (TCFD). The TCFD was established by the Financial Stability Board and offers a framework that is commonly used by companies and investors for communicating information about climate-related risks that companies may face. The TCFD Recommendations[1] specifically addresses 'Strategy' as one of the four thematic areas that represent core elements of how organizations operate.

Furthermore, in alignment with the governance pillar of the TCFD recommending that companies disclose their governance around climate-related risks and opportunities, we believe that boards should generally have explicit and clearly-defined oversight responsibilities of climate-related issues. In our experience, integrated reporting modelling TCFD's reporting framework from the board on climate and transition planning generally serves to promote comparability amongst companies while ensuring that companies articulate the board's role in overseeing a company's climate-related ambitions as part of its overall strategic oversight.

However, we caution against the decision to remove the reference to governance in the revised Provision 1. We believe that the removal from the Provision may work contrary to encouraging such TCFD-aligned best-practices reporting on climate-related issues in the context of governance.

Q3. Do you have any comments on the other changes proposed to Section 1?

Glass Lewis places a significant emphasis on promoting transparency, robust governance structures and companies' responsiveness to and engagement with shareholders. We therefore welcome the strengthening of the language in Section 1, Provision 3 and the clarity around reporting expectations therein.

[1] https://www.fsb-tcfd.org/recommendations/

With regard to the proposed amendments to Provision 2, we also recommend that clear guidance and/or a reporting framework is provided to increase the likelihood that companies provide meaningful reporting on culture (perhaps through related updates to the FRC's Culture Hub and a footnote to this resource in the Provision).

Section 2 – Division of Responsibilities

Q4. 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?

We believe that directors should have the necessary time to fulfil their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis.

We believe that all boards should be routinely assessing the ability and availability of their members to effectively discharge their duties, which should invariably include an assessment of directors' material external commitments. Accordingly, we welcome the explicit inclusion of language within Provision K to recommend this. Moreover, the proposed inclusion may contribute to more comprehensive discussion of directors' time commitments pursuant to Provision 15.

Q5. Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

While we do not apply a formulaic approach, Glass Lewis will generally consider a director to have a potentially excessive commitment level when they:

- Serve as an executive officer of any public company while serving on more than one additional external public company board; or
- Serve as a non-executive director on more than five public company boards in total.

We count non-executive board chair positions at UK companies as two board seats given the increased time commitment generally associated with these roles and view a non-executive directorship at an Investment Company as less onerous.

Accordingly, aligned with our holistic approach, we recognise the benefits and added flexibility of not adopting a numerical approach when assessing additional mandates, and may grant exceptions based on a number of factors.

When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size, location, and scope of operation of the other companies where the director serves on the board, as well as the nature of the role (including committee memberships) that the director holds at these companies, whether the director serves as an executive or non-executive director of any large privately-held companies, and the director's attendance record at all companies. In addition, we generally consider Group companies to form part of their duties and often provide exceptions in such circumstances.

In this context, we believe narrative on additional mandates is a crucial factor for investor assessment, which can supplement bare quantitative data and guide more informed decisions. As such, we support the proposed expansion of Provision 15.

Given the proposed expansion of this Provision, we believe it would also be an opportune time to review the other recommendations in this Provision. In consideration of the non-static nature of a director's external commitments and the proposed expansion of Principle K to recommend that director commitments are reviewed as part of the board's annual performance review, we believe that Provision 15 should also be amended to recommend that – annually as part of the board's performance review rather than only prior to new appointments -- the board "take into account other demands on directors' time" and "significant commitments should be disclosed with an indication of the time involved".

Section 3 – Composition, Succession and Evaluation

Q7. & Q.8 Diversity and Inclusion

Glass Lewis believes the selection and screening process for identifying suitably qualified candidates for a company's board of directors requires the examination of many factors, including the balance of skills and talents and breadth of experience, as well as the diversity of candidates and existing board members. We believe diversity of skills, abilities and points of view can foster the development of a more creative, effective and dynamic board.

While we welcome the expansion of the diversity definition to all protected characteristics, and nonprotected characteristics including cognitive and personal strengths, we caution against the proposal to remove references to "gender" and "ethnicity" from Principle I. We believe that reporting against the diversity targets set out by the FCA's revised Listing Rules, FTSE Women Leaders Review, and the Parker Review should be a material consideration for UK-listed companies. Particularly considering upcoming diversity-related target deadlines and the recent expansion of diversity-related Listing Rules to FTSE All-Small companies, we believe that it might be premature to remove explicit reference to gender and ethnic diversity from Provision 24.

We welcome the changes to Provision 24 and believe these may help to reduce the use of boilerplate language and improve disclosure surrounding progress against diversity targets and succession planning to address gaps in representation.

Section 4 - Audit, risk, and internal control

Q10. Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

Glass Lewis agrees that all Code companies should prepare an Audit and Assurance Policy on a 'comply or explain' basis. As Glass Lewis relies on publicly disclosed information for its research, we welcome any measure that promotes meaningful reporting on how a company manages risks and safeguards shareholders' interest. We believe that an Audit and Assurance Policy, on a comply-or-explain basis, would improve shareholder confidence in the quality of a company's reporting, and likely stimulate more meaningful engagement on audit-related matters. In this context, we welcome the proposed new recommendation in Provision 26 that audit committees engage with stakeholders on their role, the work of the external auditor, and the approach to the audit and assurance policy. In our experience engaging with UK companies, the audit process is rarely discussed, and audit committee members are infrequent participants in engagement meetings.

The proposal to publish an assessment of the policy every three years, accompanied by an annual progress report, also strikes us as being a reasonable approach. Further, we concur that the audit committee would be best placed to take on the responsibility of formulating the Audit and Assurance Policy and overseeing its implementation.

Q11.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?

Glass Lewis supports the adoption of the Minimum Standard for Audit Committees ("Minimum Standard") for Code companies, which we believe promotes transparency by specifying the roles and responsibilities of audit committees. Further, we agree that modifying Provisions 25 and 26 and directing Code companies to adhere to the Minimum Standard is an effective means of removing duplication. To enhance accessibility, we believe there would be merit in incorporating a hyperlink or a footnote that guides readers to the Minimum Standard.

Q12.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?

Glass Lewis believes that insufficient oversight of material environmental and social issues can present direct legal, financial, regulatory and reputational risks that could serve to harm shareholder interests. Therefore, we believe that these issues, as well as a company's reporting in this area, should be carefully monitored and managed, and that companies should have an appropriate oversight structure in place to ensure that they are mitigating attendant risks and capitalising on related opportunities to the best extent possible.

When evaluating the board's role in overseeing material environmental and/or social issues, we will examine publicly disclosed information (generally a company's annual report or sustainability report) to determine if directors maintain a meaningful level of oversight of, and accountability for, a company's material environmental and/or socially-related impacts and risks. We believe that it is important that these issues are overseen at the board level and that shareholders are afforded meaningful disclosure of these oversight responsibilities. We recognise, however, that this oversight can be effectively conducted by specific directors, the entire board, a separate committee, or combined with the responsibilities of a key committee.

In saying that, we acknowledge that the audit committee's expertise in financial reporting enables it to understand and assess the soundness of the methodologies and policies management is using to develop its metrics and other ESG disclosures. Further, in situations where we believe a company has not properly managed or mitigated material environmental or social risks to the detriment of shareholder value, it is Glass Lewis policy that we will consider recommending that shareholders vote against members of the audit committee in the absence of explicit board oversight of these issues.

As such, while Glass Lewis believes that companies should determine the most suitable structure for this oversight, we recognise that audit committees can play a vital role in bridging the gap between financial and ESG disclosures, potentially resulting in more thorough and consistent reporting. The successful broadening of the responsibilities of the audit committee is also dependent on the extent to which these additional tasks can be effectively managed by the committee, which in turn, is contingent on the presence of directors possessing the requisite skills, experience, or training on ESG-related matters. Further, should audit committees take on this expanded role, we believe any ESG-related responsibilities should be explicitly outlined in the committee's terms of reference.

Q.13-18. Risk Management and Internal Controls

Glass Lewis recognises that three major independent reviews (Sir John Kingman's Review of the Financial Reporting Council, the Competition and Market Authority's Statutory Audit Services Market Study, and Sir Donald Brydon's Review of the Quality and Effectiveness of Audit), have called for enhanced effectiveness of risk management and internal control systems at UK-Listed companies. We therefore consider appropriate, and endorse, the draft Code's objective of enhancing board accountability and reporting related to internal controls.

Glass Lewis welcomes proposals for more explicit reporting by boards regarding the effectiveness of risk management and internal control, which we believe will bolster confidence among investors and other stakeholders. Further, we agree that reporting on the performance of risk management and internal control systems reinforces directors' responsibility for these systems. In addition, by requiring that boards declare that they can reasonably attest to the effectiveness of risk management and internal control, director accountability in this area is strengthened – which, in our view is the most effective means of attaining the desired outcomes.

As Glass Lewis takes a holistic view of the companies in our coverage, and applies a case-by-case approach to reviewing all agenda items subject to a shareholder vote, we also welcome the emphasis on narrative reporting, which often provides important nuance and context for our analysis. The requirement that companies provide evidence to support their reporting and conclusions should also encourage non-boilerplate disclosures.

On the whole, we believe these proposals will likely promote director accountability and provide stakeholders with a deeper understanding of a company's risk management and internal control systems. Additionally, we do not consider any of the recommendations to be overly strict or burdensome, as companies will continue to have flexibility to tailor their arrangements to their unique circumstances.

Q.19-21 Going Concern / Resilience Statement

Glass Lewis approves of the retention of Provision 30. Further, we support the FRC's approach, as outlined in Principles 32, requiring all companies to report on 'future prospects' in their annual reports. We believe the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects.

Section 5 – Remuneration

Q22. Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

Glass Lewis believes an executive's remuneration should be directly linked with the performance of the company and that timely and transparent disclosure is critical to allow shareholders to evaluate the extent to which pay is aligned with company performance. As such, we welcome the proposed changes and believe they should aid in strengthening the link between remuneration and corporate performance. Furthermore, we agree that no executive should decide their own remuneration outcome; we firmly believe that executive remuneration outcomes should be reviewed and decided on by an independent remuneration committee to avoid potential conflicts of interest.

In addition, while we are not prescriptive when it comes to the choice of performance criteria and believe that the inclusion of ESG metrics in remuneration plans should be predicated on each company's unique circumstances, we are of the opinion that explicit ESG criteria in executive incentive plans, when used appropriately, can serve to provide both executives and shareholders a clear line of sight into a company's ESG strategy, ambitions, and targets. Acknowledging that ESG performance metrics will not be appropriate for all companies, we view the proposed links to ESG objectives favourably, particularly the strategic rationale and how it supports such objectives. As such, we welcome explicit reference to ESG objectives to increase transparency in this regard.

Further, considering the Code's 'comply-or-explain' approach, we anticipate the change to Provision 43 will likely encourage more substantial reporting regarding how the compensation system aligns with a company's ESG goals in cases where a company has not adopted explicit ESG remuneration metrics.

In addition, where companies have incorporated ESG criteria, Glass Lewis anticipates that the change to Provision 43 will lead to better contextualisation around the choice of ESG metrics. When assessing outcomes, Glass Lewis believes remuneration committees should take the overall stakeholder experience into account, including that of the wider workforce. Therefore, we believe the increased emphasis on disclosure surrounding workforce remuneration is likely to benefit shareholders and is aligned with market best practice established surrounding this area.

Q23. Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

Glass Lewis is supportive of the proposed changes to the malus and clawback provisions in an aim to improve transparency. The recommendations may provide stakeholders with ex-ante information to be able to assess if a board should have attempted to apply either following a material event.

In particular, we welcome the recommendations concerning whether the provisions have been utilised and their accompanying explanations, which we believe will benefit shareholders more generally when assessing the appropriateness of outcomes.

Q24: Do you agree with the proposed changes to Provisions 40 and 41?

We agree that many companies subject to the Code are currently addressing the components of Provision 40 in a standardised manner, which fails to provide valuable insights to shareholders. In our view, incorporating an aspect of these elements as a principle rather than a provision would help maintain the attention of remuneration committees on these issues without encouraging boilerplate disclosure.

Q25. Should the reference to pay gaps and pay ratios be removed, or strengthened?

We believe that Gender Pay Gap and CEO Pay Ratio data remain important lenses through which executive pay may be viewed. We recognise that extant regulations, outside the Code, require disclosure of, and narrative reporting regarding, CEO Pay Ratios in a company’s annual report. This narrative reporting is, however, often boilerplate. The Code may be positioned to build on, rather than duplicate, this disclosure by encouraging more meaningful, or outcomes-based, disclosure in this regard, which may contextualise year-on-year movements in remuneration.

Further, we believe the inclusion of Gender Pay Gap considerations in executive remuneration disclosure may continue to provide additional context. As such we believe the full removal of reference to the same should be reconsidered.

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Glass Lewis is available to answer any questions the FRC may have regarding the comments provided above. Additionally, Glass Lewis raises no objection to these comments being published on the FRC website.

Respectfully submitted,

[redacted]