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Sent to: codereview@frc.org.uk

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FINANCIAL REPORTING COUNCIL CORPORATE GOVERANCE CODE CONSULTATION DOCUMENT[1]

Dear David,

We are writing to make a series of comments on the above consultation paper. We administer a large master trust pension scheme, with £22bn under management and 2 million active savers.

We welcome the Financial Reporting Council's (FRC) work to create and uphold the UK Corporate Governance Code ("the Code"). The Code has played a key role in ensuring the UK remains attractive to both domestic and international investors through supporting high corporate governance standards, which help protect our members' outcomes resulting from poor corporate behaviour. We commend the FRC and the team for this achievement.

We are broadly supportive of the FRC's proposed ways to strengthen the UK Corporate Governance Code, however we recommend some additional ways in which the proposals could be further strengthened. This consultation response focuses on those recommendations and is divided into 2 sections:

- Provision recommendations (Part 1)
- FRC Guidance recommendations (Part 2)

Our response

<u>PART 1: Provision recommendations</u>

1. **Workforce and fair pay**

Fair pay is a key component to ensuring a motivated workforce that helps contribute to long-term financial performance. We are part of an investor coalition – led by the Church of England Pension Board – in compiling the Fair Reward Framework (FRF).

[1] UK Corporate Governance Code consultation document (frc.org.uk)

We are supportive of proposals to remove wording on a company's "approach to investing in and rewarding its workforce" to newly created Provision 35 and the explicit mention in the newly created Provision 43 around engaging with the workforce on remuneration issues.

However, we do not support the proposal to remove the reference to pay ratios and pay gaps from this Provision. This needs to be retained, with an emphasis on actions taken to rectify existing gaps and how these measures have been incorporated into decision making of remuneration committees. This will address FRC's concerns about duplication of reporting. Our view is that pay ratios provide helpful insights to investors on pay conditions across the organisation and more broadly, companies' contribution to systemic societal inequalities.

Whistleblowing

With regards to reinstating the wording on whistleblowing (old Principle D, Section 1), we think that the phrase "the workforce should be able to raise any matters of concern" would be important to maintain in the new Code as it emphasises the importance of having a culture and robust policy in place which supports whistleblowing. We could not find this phrase elsewhere in the new proposed Code.

2. Shareholder engagement (Provision 3)

Dual-class shares

We are hopeful that the FCA will reconsider its proposal to roll back important shareholder rights around significant transactions, related party transactions and – as it relates to this consultation – the 'one share, one vote' principle. People's Partnership was part of an investor coalition to address this issue[2].

However, if this proposal proceeds, and in light of the importance of equal voting rights to the shareholder voice and companies fully complying with Principle C to "ensure effective engagement with, and encourage participation from, [shareholders and stakeholders], we would suggest that Provision 3 be amended to explicitly include wording on how – where a dual-class share structure has been used – the board ensures it listens to and acts upon views expressed by shareholders. We would also suggest the following changes to Provision 3 (suggested exact changes in italics but the spirit of the addition is the key ask here):

"The chair should ensure that the board has a clear understanding of the views of shareholders, and report in the annual report on the outcomes of the engagement which has taken place with them during the reporting period. *Where the company has decided to put in place dual-class share structures, it should report in the annual report what additional measures have been put in place to ensure the views of*

[2] FCA listing proposals risk "undoing stewardship progress" say UK pension schemes (railpen.com)

shareholders are listened to and acted upon, and its assessment of the effectiveness of such measures. This should include any relevant examples and outcomes.

AGM attendance

We believe that Provision C should be further strengthened to clarify how boards should take responsibility for ensuring that AGMs are managed in such a way as to support genuine engagement with shareholders.

Specifically, we do not believe that purely or mostly virtual AGMs allow for full democratic participation. Experience from other investors has been that it is easier for companies to choose which questions from shareholders they wish to answer, thereby making it harder for shareholders to be heard more generally. We ask that the FRC consider the wording and expectations included in Principle 10 of the ICGN's Global Governance Principles with regards to this issue.

3. **Consideration of environmental, social and governance (ESG) issues**

The importance of governance

We would reinstate reference to the need for the annual report to include how governance contributes to delivery of company strategy. Good governance is the foundation of addressing material environmental and social issues and we think this should be referenced in the Code.

How a company approaches those ESG issues deemed to be the most material to performance is the priority of investors. Therefore, we suggest that the FRC:

- Insert the phrase "material" into its reference to environmental and social issues. This would include references in the newly created Provisions 1, 27, 34 and Principle P.
- Define "ESG" in this document as "**financially material** ESG investment factors" (or similar). In an environment in which the concept of fiduciary duty is being relooked at, this would help clear up any confusion around what is meant by this term and would be a good first step to support broader clarity of language across the industry.

In addition to investors being able to identify which issues the companies deem to be the most material, companies would also be able to look to the Code to help them withstand pressure from internal and external stakeholders and campaign groups to focus on less pertinent ESG issues.

ESG Reporting

We concur with the FRC that the Audit Committee is the most appropriate oversight body for ESG reporting in the majority of circumstances. However, there may be exceptions to the rule (ie., Sustainability Committee) in which another Board committee may have oversight for the ESG issue of concern. Therefore, there should be some flexibility embedded within the Code where if the company can provide an appropriate rationale for doing so, alternative oversight approaches are also acceptable.

PART 2: FRC Guidance recommendations

The below table provides a summary of FRC Guidance recommendations

Topic	Guidance recommendation
Outcomes-based reporting	Examples of what would be considered a good outcomes of good governance
Whistleblowing	Disclosure on how effective whistleblowing mechanisms have been during the year e.g., the number of incidents/ breaches of policies and the actions taken to address issues (including termination) will provide confidence to investors that instances of unethical or illegal conduct are dealt with appropriately
Reporting on shareholder engagement	The level of detail that should accompany reporting on shareholder engagement, for example: areas of progress following shareholder feedback including publication of policies/reports, enhancement of governance/internal mechanisms, examples of issues that are under board consideration for coming years.
Overboarding	The term 'significant' external commitments to ensure a level of common understanding of the term
Diversity reporting	Reporting should contain challenges in meeting targets and qualify any regression in performance
Audit and Assurance Policy	Minimum standards for acceptable reporting. Details how companies can report on a scale proportionate to the level of maturity of the firm in these areas.

Remit of Audit Committee regarding narrative reporting (including sustainability)	How audit committees should be supported on sustainability matters i.e., they must be provided with access to internal and external expertise and where skills gaps are noted via performance reviews, additional training should be provided to ensure that committee members stay abreast of developments including regulatory requirements
Risk management and internal controls	What boards making a declaration around effectiveness of risk management and internal controls will need to do at the very minimum, covering both processes and desired outcomes
Executive pay and ESG	Setting of ESG-linked pay in ways that are substantive and meaningful in the context of their operating conditions

We trust that our consultation response proves helpful. We would welcome the opportunity to discuss these and other related issues further with the FRC.

[redacted]