OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

12 September 2023

Financial Reporting Council

Response submitted via e-mail to: codereview@frc.org.uk

Dear Sir / Madam,

UK Corporate Governance Code
IUA response to the FRC consultation paper

We[1] are writing in response to the FRC consultation on the proposed amendments to the UK Corporate Governance Code ('the Code').

Though we will provide views on the overall tone and principles underpinning the audit and corporate governance proposals and potential impact on listed firms and on institutional investors in those firms applying the Code, we would highlight that an additional focus is on the impact on the provision of insurance to those affected by the proposals – for example company directors and officers. Because our membership is diverse in terms of size, corporate structure and geographical spread, the pure corporate governance related proposals may affect members differently and, while we have taken soundings from our members on these aspects of the proposals, we understand that some may also be responding separately on these points. The implications for insurers providing insurance are likely to be more common.

General Comments

1. Subject to our comments below, we support periodically reviewing the Code with a view to bolstering the regulatory framework and improving investor and consumer confidence in the internal control functions within large firms. Clear, robust and properly enforced standards can only be beneficial and, for insurers underwriting these firms and directors, will help make the sector more attractive as a risk proposition.

2. Proportionality is emphasised in the consultation paper, and we continue to strongly support building this into the core Code provisions (including retention of the 'comply or explain' backstop), particularly in considering the relative benefits of the proposals against the implementation costs for firms and the financial and operational impact on the services that they are able to provide.[2]

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1 The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. It exists to promote and enhance the business environment for its members. The IUA's London Company Market Statistics Report shows that overall premium income for the company market in 2022 was £44.071bn. Gross premium written in London totalled £37.626bn, while a further £6.444bn was identified as written in other locations outside London, but overseen and managed by London operations. For further information about our organisation and membership, please visit our web site, www.iua.co.uk, under the section "About the IUA".

2 We note that the FT reported in 2021 that the proposed amendments to the Government's audit reform package and FRC changes to the Code could add more than £430m to business costs.

3. In considering proportionality, the issue of UK competitiveness is important. Care has to be taken to balance the need for an effective framework against putting in place disproportionately onerous requirements that go beyond what we see in comparable, competitor jurisdictions. Promoting UK competitiveness and growth is now embedded into the FCA and PRA operational objectives and we think this should also be a key principle in considering the Code, lest it prove an inhibitor to companies operating as a listed entity in the UK[3] and/or, equally importantly, to individuals (particularly those non-financially trained) from seeking NED roles in the first place (or their becoming disproportionately expensive to employ). We think the current Code in many places gets this balance right, but there are some concerns that the more in-depth reporting requirements, particularly around internal controls, will lead to increased liabilities for companies and company directors, will be costly to implement and arguably disproportionate in consideration of the actual current problems in respect of UK corporate governance and evidenced tangible benefits accruing from the reform proposals.

4. It is worth highlighting that we would expect the proposals to lead to director liability actions increasing, with consequent impact on the provision and cost of Directors and Officers insurance. The requirements in the Code relating to ESG, diversity and inclusion, identifying and managing emerging risk, remuneration and on ensuring that directors are dedicating sufficient time to their role all place directors at the heart of implementation of the new requirements and we would expect this to manifest in increased actions against D&Os.

5. We support the intention to draft guidance on key aspects of the revised Code. However, given that some of the amendments introduce broad principles and may require significant operational change (particularly on internal controls), it would be prudent to also consult on this guidance prior to publication and include within it examples of good and poor practice.

Consultation Questions

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

Yes. Though we had no significant concern with the operation of this section, focusing on the practical outcomes of the corporate policies is logical, as does the requirement to clearly explain any departures from the Code. That said, it would be useful to have more clarity on how to measure whether a corporate strategy has been 'effective'.

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?

Yes, subject to the following comments. Whilst increased focus on climate change and transition planning is clearly in tune with regulatory and wider stakeholder expectations, care has to be taken not to duplicate or conflict with existing national or international requirements. Moreover, meeting 'the needs and expectations of stakeholders' may have differing connotations dependent upon the stakeholder in question. For example, there has been much ESG litigation related to

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[3] Or indeed does not become an inhibitor for the many non-listed entities that currently voluntarily apply the Code.

'greenwashing' and ESG preparedness. However, more recently, we have also seen some 'anti-ESG' litigation relating to directors' obligations to maximise shareholder benefit. Moreover, the various tenets of ESG can change rapidly, subject to continuing societal debate and regulatory focus, which in some cases makes it difficult for businesses to respond to quickly. It is also immature in the sense that external bodies undertaking ESG ratings, whether by industry or individual company, are relatively new in concept and are rarely comprehensive.

So, whilst greater transparency around corporate ESG and climate change policies is welcomed, measuring success in this area may be more nuanced and more specifically referencing and emphasising it in the Code may lead to greater disputes on company performance.

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

No.

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?

Whilst emphasising a performance element in the annual review is not, in itself, problematic, we were relatively comfortable with the existing principle on Board composition, including the commitment to contribute effectively to the Board. We are cognisant here of the relatively small pool of talented NEDs available and not losing some of that talent with overly onerous checks on their non-company commitments and potentially restricting their ability to work (assuming that some directors will choose to err on the side of caution and avoid potential liability claims). Further, as the consultation paper states, 'it is difficult to be precise about how much time each Board position demands', so the more generic principle on effectiveness would remain preferable.

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?

We understand the rationale behind the proposal but would question whether the level of granularity in the reporting might be disproportionately onerous for companies. Moreover, we would expect that directors should already have a clear idea of their workload in order to effectively fulfil their obligations; therefore this extra measure would have relatively limited benefit (though may be of use for companies in considering prospective director appointments).

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

Yes. We agree with the broad principle to support existing principles that have been recently introduced and are still bedding in.

Q7: 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?

Yes. Though gender and ethic diversity are the key current focus of regulators, we think a broader commitment to equal opportunities and diversity and inclusion works equally as well, perhaps

future proofs the Code and helps promote diversity of thought, which we see as a crucial requirement for companies and Boards. More generally, the increased prominence on diversity in the Code may lead to increased scrutiny of directors and employment liability claims that would likely be picked up by a D&O insurance policy.

Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

Yes. Though the main requirements do not appear to have significantly changed, they are slightly clearer.

Q9: 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?

We agree that a less prescriptive, principles-based approach is preferable and are content to follow the core elements of the CGI review. We also agree that guidance relating to the operation of Provisions 21 and 23 of the current Code would be beneficial.

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

Yes.

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?

Yes.

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?

We would refer to our comments in Question 2 above on ESG analysis and reporting and also maintain a wider concern that overly prescriptive and onerous reporting requirements in this area may impact UK competitiveness. That said, we recognise the growing need for transparency around companies' sustainability and ESG policies and favour developing a common approach to reporting that complements existing regulatory requirements. We also agree with maintaining the flexibility for the Board to undertake this; otherwise the audit committee would do so.

Q13: 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?

When responding to the 'Restoring trust in audit and corporate governance' consultation, we noted that the proposals in relation to reporting and greater accountability on internal control effectiveness were largely sensible and aligned with the longstanding responsibilities for directors to oversee the implementation of an effective and targeted framework of financial and other internal controls. Further, provided that the new regulations sought to build incrementally on existing practice and guidance for the operation of internal controls and focused on material issues, while

allowing for some variation in practice appropriate to different sectors, we cautiously welcomed a greater codification of expectations and requirements in respect of internal controls.

Looking at the current proposals, we agree that the proposed guidance, when drafted, will be valuable and necessary (and should be consulted upon). However, the key is to 'allow companies flexibility to adapt it to their unique circumstances and characteristics (e.g. industry, size, geography etc)'. To that end, the guidance must be complementary to Boards' decision-making processes and not be overly prescriptive. Moreover, there is a concern that the significant increase in the level of detail (based on the guidance criteria) required to be assessed and reported upon by the company will lead to notable increased operational costs. It would be valuable to understand from other respondents to the consultation how much additional analysis and costs will be required in implementing the proposed reporting requirements.

Q14: 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? FRC | UK Corporate Governance Code consultation document | May 2023 31

The date of the balance sheet would be proportionate. Obviously, one would expect ongoing analysis to be necessary to inform the balance sheet date assessment and this could be emphasised in guidance.

Q15: 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?

We think that the existing reference to monitoring and review covering 'all material controls' remains sufficient to cover off important information – covering off both financial and non-financial issues. There is a concern that the increasing focus on narrative reporting will lead to (at least a perception of) SOX style granularity of reporting, which we do not think is the FRC's intention, and would be disproportionately onerous. If the proposals are taken up as proposed, the full intention of this needs to be clearly clarified in guidance.

We also note that the Department for Business and Trade are also looking at non-financial reporting in their Smarter regulation review and this needs to be considered when developing the Code provisions.

Q16: 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?

This would be helpful but should not be prescriptive.

Q17: 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?

No.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

No.

Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

Yes.

Q20: Do you agree that all Code companies should continue to report on their future prospects?

Yes.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

Yes.

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

We agree that the amendments to what is now Principle O are reasonable and suitably link to strategy and long-term sustainable success. In respect of Principle P, we hold some concerns on the specific reference to ESG, linking back to comments in previous questions on the relative embryonic nature of ESG measurement and evolving ESG priorities. We think reference to long-term strategy remains sufficient.

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

Yes.

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

Though the consultation notes that many companies aligned their remuneration reports around the guidance in Provision 40, it does not follow that the reports given are necessarily inadequate. That said the revised Provisions continue to provide clarity on what is expected of companies.

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

We agree that if this information is captured elsewhere then any duplication should be avoided.

Q26: 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?

Not that we can think of presently.

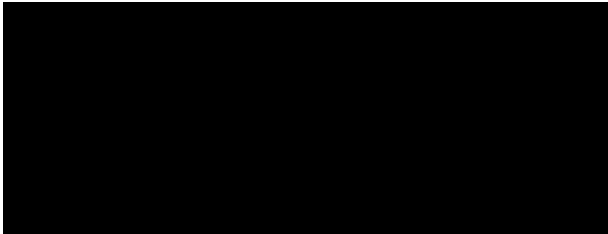
Concluding Comments

We have added some further comments on insurance directly below which, whilst not directly relating to the consultation questions, offer some further context on our position.

IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

We hope you find these comments useful in developing the revised UK Corporate Governance Code. We would be willing to clarify or expand on our position as required.

Yours sincerely,



Further comments

The below comments mirror those made to BEIS in the earlier 'Restoring trust…' consultation but we think bear reiterating here as general comments on corporate governance and also a wider comment on the provision of insurance to those professionals involved in corporate governance related roles.

Increased Accountability

The potential increased accountability for directors and audit committees should help drive the standard of reporting and the interaction between the Board and the Audit Committee. However, this will have an impact on potential insured liabilities, which we consider further below. Moreover, there is already a paucity of qualified NEDs available and care has to be taken to ensure that the measures are proportionately drafted and applied and do not deter NEDs from seeking roles in the first place. While we understand that, ultimately, the Board has collective responsibility for application of corporate governance provisions - which implies that there should be collective enforcement – it may be more proportionate to apply the Kingman report proposals to limit the application of rules to those most directly responsible – for example relating to the accounts, the CEO, CFO, Chair and Audit Committee Chair. If not, perhaps a preferable middle ground would be to specifically build into the new regulator's powers the flexibility to approach enforcement with proportionality at the forefront when it considers the respective backgrounds and expertise of directors.

Impact of the provision of insurance

In respect of the provision of Professional Indemnity insurance (PII) to firms providing audit, accountancy and actuarial services, a transparent, more effective regulatory structure is to be welcomed. While a better audit framework will not stop companies suffering high profile business failures, it should mitigate the risk of these escalating or being facilitated by negligent audits. More generally, though there will be some new requirements for external auditors which may lead to a revised risk profile and potential premium adjustments, the underlying exposure has not fundamentally changed and insurers will adapt to the new framework and continue to rate the risk based on the firm and their individual circumstances - their client base, fee income, historic loss record and risk management controls in place.

For Directors & Officers insurers the risk profile will change more significantly if the proposals are taken forward as proposed. The increased and more targeted accountability and responsibilities all directors of in-scope companies will face will inevitably lead to increased liabilities, greater susceptibility to regulatory investigation and more claims being brought against directors and the firm by relevant stakeholders. Even spurious claims need to be defended and one would imagine directors facing individual liability would be even more motivated to fight any claims. One would also surmise that individual directors' D&O insurance requirements will evolve to ensure that their new individual liabilities are met.

In short, unlike PII, where the proposals largely develop an existing risk, this is a new liability for directors, which insurers will need to build into their modelling and pricing strategies. It is difficult to make a definitive judgement on how insurers will react to the changes, as each will take its own view based on its underwriting approach, existing portfolio of risks and corporate appetite for the class of business. This is particularly so where, as matters currently stand, there is little detail as to the exact scope of the proposed new regulator, ARGA, its' investigatory and enforcement powers and other relevant elements of the proposed new regime. However, as with any emerging or regulatory risk where the potential frequency and severity of insured losses increases, there will be a range of options available to insurers - increased premium, restrictions on policy terms (whether it be sub-limits for audit / internal controls-related risk or more widely around defence and investigation costs), specific exclusions similar to those for Sarbanes-Oxley exposures or increased coinsurance and excesses required of insureds.

The above comments should not be read as our disapproval of the corporate governance proposals – as noted above many of the proposals are sensible and required – but it would be remiss not to outline what may be the impact on the provision of insurance (in terms of availability, scope and pricing).

ENDS