Herbert Smith Freehills LLP
Exchange House
Primrose Street
London EC2A 2EG
T +44 (0)20 7374 8000
F +44 (0)20 7374 0888
DX28 London Chancery Lane

www.herbertsmithfreehills.com

By email

Date
13 September 2023

Dear Governance Code Consultation Team

UK Corporate Governance Code Consultation

We write with our comments in response to the "UK Corporate Governance Code Consultation" published by the Financial Reporting Council (**FRC**) in May 2023 (**Consultation Paper**).

Herbert Smith Freehills is an international law firm operating from 24 offices across EMEA, Asia Pacific and North America. The firm advises UK and international publicly listed and private companies operating in the UK and globally across a wide range of sectors and is one of the few law firms with a dedicated corporate governance practice. We have been engaged in, and contributed directly to, discussions on governance reform for many years, across the UK Corporate Governance Code (**Governance Code**), company law, the listing regime and other governance frameworks. We have responded in detail to the original government consultations on governance and related reforms.

We would like to take the opportunity to make some general comments in relation to the Consultation Paper:

- We would like to acknowledge the **FRC's desire to conduct a meaningful consultation**, demonstrated through the time afforded for interested parties to respond, the level of outreach and engagement by the FRC during the consultation period and the FRC's openness to receiving constructive and frank feedback. The manner in which the FRC has conducted the consultation process has sought to maximise the opportunity for stakeholders to engage with the proposals properly, which increases the chance that the resulting Governance Code will drive proportionate and sustainable changes.

- We also would like to acknowledge that in a number of areas, the **FRC was tasked with amending the Governance Code by the government** in its Restoring trust in audit and

Herbert Smith Freehills LLP and its subsidiaries and Herbert Smith Freehills, an Australian Partnership, are separate member firms of the international legal practice known as Herbert Smith Freehills.

Herbert Smith Freehills LLP is a limited liability partnership registered in England and Wales with registered number OC310989. It is authorised and regulated by the Solicitors' Regulation Authority of England and Wales. A list of the members and their professional qualifications is open to inspection at the registered office, Exchange House, Primrose Street, London EC2A 2EG. We use the word partner of Herbert Smith Freehills LLP to refer to a member of Herbert Smith Freehills LLP, or an employee or consultant with equivalent standing and qualifications.

corporate governance: Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems paper published in May 2022 (**Government Response**). In responding to the Consultation Paper in these areas, we are therefore mindful that the FRC's proposals reflect the positions articulated in the Government Response.

- However, it should be noted this reform process **started in a very different political context**, under the purview of a previous government far less reticent about increasing the level of regulation in force as a means of signalling that it was responding to the issues of the day. The current government, notably No 10 and the Treasury, has so far demonstrated a much greater willingness to impose additional regulation only where there is clear evidence that a regulatory response is the most appropriate and proportionate tool to address the matter at hand and to be sceptical of the benefits of regulatory change absent clear evidence of that proportionality and benefit.

- Whilst good corporate governance standards play a part in ensuring investor confidence in a particular market, **overly prescriptive standards and excessively onerous disclosure burdens decrease the attractiveness of a market** as a business and investment environment. The need to ensure that the UK market remains attractive whilst maintaining a balanced and proportionate regulatory regime is evident in a number of recent legal and regulatory proposals, not least the Financial Conduct Authority's wholesale review of the UK listing regime with a stated desire to make the current regime more accessible, effective, easier to understand and competitive for the benefit of issuers and investors. Considered in this light, there are aspects of the Governance Code which we believe were introduced in good faith but which have proved to be disproportionate and out of step with the overall desire to increase the competitiveness and accessibility of the UK markets, with high standards. In our view, the way in which the Governance Code has been applied in practice has already, in too many cases, led to a disproportionate focus on governance processes and too little time on substantive business and strategic outcomes. This approach is leading to challenges for the UK listed markets as compared with overseas listed markets and against private capital investment opportunities. In this context, **the FRC should be mindful of how any proposed changes to the Governance Code will be applied in practice**.

- The Governance Code places significant focus on non-executive directors (**NEDs**). Originally the impact on NEDs of earlier iterations of the Governance Code centred on their role in the oversight of management. This focus on NEDs reflects the origins of the Governance Code, at a time when the challenge of governance was principally over powerful executives. It seems to us as great a challenge today is overburdened NEDs, distracted by process ahead of proportionate substance. NEDs can and should provide oversight, but they can never prevent all problems within companies. Nor can executives, but in most cases primary responsibility rests with them – we urge to the FRC to recognise this explicitly. As it has developed and its scope has been expanded, the provisions of the Governance Code have involved boards in areas such as internal controls and ostensibly not just in the oversight of the management of these areas. Whilst we agree there should be board involvement in these areas, responsibility for aspects of these matters lies primarily with the executive management team. **The proposed changes to the Governance Code would in our view continue to underfocus on the role and responsibilities of the executive team**, placing disproportionate expectations on NEDs, who serve their companies on a part-

time basis. We realise that this is not the FRC's intention but our expectation is that this will be the outcome given how some of the proposals are framed.

As well as these general comments, we set out below specific comments on certain of the questions from the Consultation Paper. Please note, as a matter of formality, that the views expressed in this letter are the views of our firm and do not necessarily reflect those of our clients. For those questions on which we have not provided feedback, we do not express an opinion either way.

SECTION 1

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

We welcome the strong emphasis that the FRC places on the "comply or explain" nature of the Governance Code which is reiterated in the changes to Principle D and for its vocal support of those companies that choose to "explain" where they consider that approach to be in the best interests of the company. However, as the FRC is aware, this approach is not shared by all in the governance eco-system and there is a disconnect with some investors, proxy advisers and others approaching compliance with the Governance Code as a box-ticking exercise without scope for flexibility. We understand why they do so given their limited resources: this is not a criticism, just an acknowledgement of reality. Any changes to the Governance Code should therefore be mindful of the risk that they may be interpreted overly prescriptively in practice.

Whilst we are generally supportive of outcomes-based reporting in many areas, we are concerned that there is too much focus on measurable outcomes and too little focus on important but complex aspects of governance where the connection between a governance practice and an outcome is not easily provable, and where the impact may not be seen for many years. Governance issues such as succession planning and culture are implemented over the long term and their outcome is very hard, if not impossible, to prove. If outcomes-based reporting focuses on, and is driven by, quantifiable metrics, there is a risk that this will lead to short-termism, and that companies will be judged solely by reference to immediate outputs. We would expect the revised Guidance on Board Effectiveness to discuss outcomes-based reporting to support more reporting in this area, acknowledging that outcomes-based reporting is not possible in all circumstances and in relation to all areas of governance practice and that outcomes can be assessed over the short, medium and long term.

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?

Climate ambitions and transition planning are topics which are already covered by an array of current and forthcoming ESG reporting requirements (with the current TCFD-aligned reporting under the Listing Rules, the new Non-Financial and Sustainability Information Statement requirement in the Companies Act 2006, the proposals for the future endorsement of the ISSB's sustainability disclosure standards in the UK and the work being carried out by the UK Transition Plan Taskforce on climate transition plan disclosures) and as such we are concerned that changes to the Governance Code risk duplicating the requirements. The current (and proposed) wording of Principle A and the references to long-term sustainable success and contributing to wider society adequately address these issues in the interim without adding additional complexity to the current reporting landscape. We risk all regulatory regimes wanting to be seen to support ESG goals: this is not proportionate or a good reason for requiring new disclosures in the

Governance Code. Much like the diversity and inclusion reporting requirements referred to in paragraph 26 of the Consultation Paper, the reporting landscape in this area is fragmented and we believe that the FRC should not add to what is already a complex reporting landscape. Whilst we acknowledge that this is an area of increasing importance and focus, we would advocate that the FRC wait and see whether and how these other reporting requirements deliver the desired changes before making these proposed changes to the Governance Code and that any future changes made should be considered as part of the overall ESG reporting framework.

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

We agree with the majority of the other changes proposed to Section 1 and agree that they are helpful clarifications or adjustments.

In relation to current provision 2 and the assessment and monitoring of culture, and current provision 6 and the review of whistleblowing arrangements, we do not agree with the proposed changes that the board should report on how effectively the desired culture has been embedded or that the board should consider the effectiveness of its whistleblowing arrangements. This is for similar reasons to that outlined above in relation to outcomes-based reporting – in particular in the context of embedding culture, it is likely to be challenging to make an assessment of the effectiveness of how culture has been embedded (beyond perhaps employee pulse survey results) and similarly in the context of whistleblowing arrangements, these are likely to be adjudged effective unless and until a matter arises which was not raised through those procedures. We would instead propose that in the context of culture, reporting is limited to how the board have sought to embed the desired culture, which is likely to be more meaningful and give greater insight into companies' activities in this area, rather than asking them to opine on how effective the process of embedding the desired culture has been. In the context of whistleblowing arrangements, we would advocate that the board assess the appropriateness rather than the effectiveness of those arrangements (that is, ensuring that they remain fit for purpose rather than effective).

In relation to current provision 3 and the change to engage, rather than seek engagement, with shareholders, please see our comments below under Question 10 on the proposed changes to current provision 25 (new provision 26) in relation to engaging with shareholders on the work of the audit committee.

SECTION 2

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?

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?

Whilst we agree with the FRC that those in leadership positions should be able to devote sufficient time to discharge their responsibilities, we do not consider the proposed changes will achieve that policy objective. In our view, they would lead to further boilerplate reporting in this area and will exacerbate the box-ticking approach adopted by certain investors and proxy advisers.

HERBERT
SMITH
FREEHILLS

We wholeheartedly support the FRC's stance that it should not impose any maximum number of appointments or maximum commitments, since this would be arbitrary and could not possibly take into account all the various demands on an individual director and how efficiently these are handled by that director. However, we do not support the proposed change to current provision 15 (as further described in paragraph 25 of the Consultation Paper as requiring granular disclosure of committee roles for example) and consider this change would lead to boilerplate reporting.

Whether an individual director has sufficient capacity to be an effective member of the board is a question for the chair and the senior independent director and this should be considered in the light of the totality of their contribution to the company. The review should consider all demands on a director and not just formal commitments to other organisations as a director's commitments should not be defined only by other board roles. A director's health, hobbies, family commitments and a host of other functions are equally important. This focus on overboarding has become a highly misleading metric and an example of imperfect metrics driving the wrong outcome in some situations.

SECTION 3

Diversity & Inclusion

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

   We fully support measures which will support companies in developing a diverse pipeline for succession and there should be transparency in relation to initiatives to promote diversity and inclusion and the impact of these initiatives. We also agree that succession oversight and planning are key roles for boards, albeit ones that are extremely difficult to evidence other than over very long-term periods. Whilst we acknowledge the FRC's concerns in relation to current disclosures by companies in this area, we are concerned that requiring granular disclosures about the diversity policy for succession to board level as appear to be advocated by new provision 18 and new provision 23 could lead to excessive transparency and remove confidentiality and privacy for individual candidates. As such, we consider that a more proportionate disclosure regime would be preferable in this area, allowing companies more flexibility to describe their arrangements and processes at a high level (i.e. what actions have been taken to reflect diversity and inclusion factors into succession processes rather specific details on the actual/anticipated impact on the talent pipeline) so as to give investors the comfort that they seek that succession plans are in fact in place.

   In terms of the other proposed changes in this area, whilst we agree that most of the changes do go some way to assisting companies in adopting a more joined-up approach in relation to diversity and inclusion requirements and initiatives, we would encourage the FRC to go further and reduce some of the duplication that is currently contained in the Governance Code and is proposed to be retained going forward. For example, current provision 23 (new provision 24) requires the disclosure of the gender balance of those in senior management and their direct reports, which was introduced in 2018 to reflect the then Hampton-Alexander Review recommendations. There are now multiple disclosures required in this area including in the strategic report under the Companies Act 2006 and the Listing Rules (as acknowledged by the Consultation Paper), each of which uses a different definition of "senior management" or

"executive management". We would encourage the FRC to consider whether this provision remains necessary, especially:

- in light of the proposed additional disclosures in current provision 23 (new provision 24) which would require companies to report on their progress toward company diversity and inclusion objectives and adherence to established initiatives (which is our view should refer to "progress towards established initiatives" rather than "adherence" as that is more in line with the voluntary nature of those initiatives and supports the "comply or explain" governance environment); and

- given there is no similar reference to the reporting expectations under the Parker Review.

In relation to the proposal for the annual report to discuss the "effectiveness" of the diversity and inclusion policy, our comments outlined above in relation to outcomes-based reporting and governance issues being implemented over the long term and their outcomes being hard to quantify are also pertinent. For example, just because one or more of the FCA's diversity or inclusion targets or the targets set by established initiatives have not been met does not mean that a diversity or inclusion policy is ineffective. Instead, we consider that it would be preferable for companies to describe their diversity and inclusion policy and their progress towards established initiatives rather than overtly describe their effectiveness.

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?**

   We support the drive to promote and increase diversity in its widest sense and to allow companies to make appointments and structure succession around whichever diversity characteristics are most appropriate in their context.

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

   See our comments above under Question 6.

<u>Board performance reviews</u>

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?**

   There is not a single approach to board evaluation; the approach a company adopts will depend upon the challenges it is faced with. There should therefore not be a drive to a single market standard. Whilst we welcome the CGI guidance as a way of improving standards in this area, the FRC should be wary of a wholesale adoption of the guidance. The FRC should ensure that any adoption of the guidance does not extend the level of granularity in the market expectations in relation to how individual boards conduct their board evaluations, particularly in the context of smaller listed companies. We would encourage the FRC to consider whether there should be a relaxation in this area for companies outside the FTSE 350, which would be consistent with

flexibility afforded to companies outside the FTSE 350 in terms of the triannual external review/evaluation process which is provided for in current provision 21 (new provision 22).

SECTION 4

Audit & Assurance Policy

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

    We note that the government took an active decision to limit the scope of the Audit and Assurance Policy (**AAP**) disclosure requirement to large UK-incorporated companies. It has developed a definition of "companies with a high level of employees and turnover" as the basis of the AAP requirement to target a specific sub-set of the listed company community, seeking to ensure a proportionate approach, rather than use the existing "quoted company" definition in the Companies Act 2006 which would have captured all UK-incorporated listed companies.

    To align with the government's approach, we therefore do not think that it is appropriate or proportionate to require all companies that apply the Governance Code to prepare an AAP, regardless of their size, and we believe that the starting point should be that only those companies that exceed the size threshold set out in The Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023 (as currently drafted) (Regulations) should be required to produce an APP. We acknowledge that there will be a number of significant companies that apply the Governance Code which would not be required to produce an AAP pursuant to the Regulations because they are not UK-incorporated companies. We therefore consider that a more proportionate approach would be for any new provisions of the Governance Code in relation to AAPs to apply to FTSE 350 companies. This would be in keeping with the intention that economically significant companies are in-scope (including those incorporated overseas) but would not burden smaller listed companies. This would also be preferrable to the "comply or explain" approach which, if a smaller company chose not to comply and given our earlier comments about comply or explain reporting in the wider governance eco-system, would put those companies "on the back foot" by explaining. Referring to FTSE 350 companies aligns to the approach taken in relation to other aspects of the Governance Code where companies outside the FTSE 350 benefit from more flexible provisions. In this regard, we note that the FRC could take this opportunity to refer consistently to either FTSE 350 companies (current provision 21/new provision 22) or "smaller" companies (Footnote 10 to current provision 24/new provision 25).

    For the avoidance of doubt, we think that the AAP statement as a new reporting requirement should be treated differently from the going concern and viability aspects of the resilience statement, which will be applied to all Governance Code companies by virtue of the changes to current provisions 30 and 31 (new provisions 31 and 32) (see our further comments on the proposed approach on current provision 30 (new provision 31) in response to Question 19). Governance Code companies are already required to make going concern and viability disclosures under the Governance Code and we agree that they should continue to do so, but that this can be done by complying with the new requirements to include a resilience statement in the annual report contained in the Regulations.

In relation to the addition to current provision 25 (new provision 26) and the commentary in paragraph 40 of the Consultation Paper on engagement with shareholders and others on the work of the audit committee, we would encourage the FRC to reconsider:

- whether there is a substantive issue or concern that needs to be addressed in this area or whether the lack of reporting on engagement is due to there being generally a lack of demand for engagement or concerns in this space; and
- whether effectively codifying engagement by including this provision will drive standardised "box-ticking" behaviours, diverting time and attention from other issues and concerns, and result in boilerplate disclosures.

Audit Committees and the External Audit: Minimum Standard

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?

We agree that cross-referring to the Minimum Standard would be an effective way to remove duplication but the proposed changes do not remove all duplication. For example, in current provision 25 (new provision 26) the bullet on effective competition is a summary of parts of the Minimum Standard and the bullet on non-audit services is a copy-out of the penultimate bullet of paragraph 4 of the Minimum Standard. This duplication should be removed.

However, as with the proposals in relation to the AAP outlined above, we have concerns about the appropriateness of applying the Minimum Standard to all companies that apply the Governance Code. We note that in paragraph 7.1.12 of the Government Response, it indicated that these requirements "*should apply initially to FTSE 350 companies. Once the requirements have been implemented, ARGA will monitor their impact and the Government will consider whether they should be extended to a wider community of PIEs*". This clearly envisaged the requirements set out in the Minimum Standard applying for a period of time to a limited community of companies, following which their impact and effectiveness would be reviewed before they were extended to other companies. We are concerned that the FRC's proposals omit this phase of review and jump straight to applying these provisions to all companies that apply the Governance Code before any reporting or application of the Minimum Standard by FTSE 350 companies has been seen (and are still bedding down at most FTSE 350 companies having only been published in April 2023), let alone any review of their impact having been carried out.

Sustainability Reporting

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?

We agree that ESG factors and sustainability are essential considerations for companies throughout the world and agree that the Governance Code should reflect this. We also strongly agree with the FRC that it would not be appropriate to recommend that companies have sustainability committees for the reasons given in paragraph 49 of the Consultation Paper.

In relation to narrative reporting, in our view there may be another appropriate board committee in whose remit narrative reporting should fit. Wherever responsibility lies, it must be kept in mind that non-financial metrics are not the same as financial metrics and each require different considerations and expertise to review. Whilst there may be a role for the audit committee in relation to the review and assurance of ESG metrics, especially if the external auditor is also providing assurance over these metrics, it should not be presumed that the audit committee or full board are the only good options. It might be better to frame the provisions of the Governance Code as requiring disclosure of who has responsibility for narrative reporting and how oversight of narrative reporting, including ESG metrics, is provided (for example, through additions to Section 1 of the Governance Code rather than changes to Section 4 as currently proposed). That would allow more flexibility for companies and would avoid explanations of non-compliance where sustainability committees (where they exist) or other committees or the board itself undertakes that oversight function.

Risk Management and Internal Controls

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?

The government tasked the FRC with strengthening the internal control provisions in the Governance Code "to provide for an *explicit statement from the board about their view of the effectiveness of the internal control systems (financial, operational and compliance systems) and the basis for that assessment*"[1] (emphasis added).

The FRC proposes to implement this through requiring the board to make a declaration in the annual report as to whether the company's risk management and internal control systems have been effective. This approach risks the declaration being interpreted as a statement that, since the board believes that the systems have been effective, risks have been eliminated. Risk is an inherent part of any business and that implication leaves the company exposed to an increased litigation risk of being sued in the situation where subsequent events develop in a way which undermines the declaration and could not reasonably have been foreseen at the time the declaration was made. We do not support the proposed approach as companies may often feel forced to give an exaggerated sense of confidence by declaring "effectiveness".

An alternative way to implement the government's request, which we believe would be far more proportionate and realistic and would provide better transparency and board oversight, would be by requiring the board to describe how the systems are "appropriate and proportionate" in the light of the material risks faced by the company and identified by the board. Though it would not be our favoured approach, if the FRC wishes to maintain reference to the "effectiveness" of the systems, then the disclosure by the board should set out the limits of systems' effectiveness, as no system is entirely effective to eliminate risks – risk is inherent and can be managed, but not eliminated. Yet effectiveness suggests elimination to many investors.

[1] See paragraph 2.1.34 of the Government Response

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?

Whilst we agree with the statement in paragraph 64 of the Consultation Paper that monitoring should not be seen as a one-off exercise, we do not think that "throughout the reporting period" should be interpreted as "continuously". Whilst the internal control systems should apply throughout the year and it should be possible to assess their application periodically during the period, it is not possible for the board to make a declaration on a continuous basis. The explanation provided by the board should instead make clear the basis for the declaration, including (to address the concern behind the change) the processes that were in place during the reporting period to enable the declaration to be made.

With regard to NEDs, if the monitoring requirement was interpreted as a continuous one, this would lead to a further blurring of the line between the role of NEDs (who are engaged on a part-time basis) and the executive team. Whilst the NEDs can and do engage with the company at multiple times throughout the financial year, requiring a declaration from the NEDs based on continuous monitoring would be out of keeping with their role.

In our view, the declaration should be based on the date of the balance sheet and should not be extended to the date of the annual report and accounts. The annual report and accounts speak to the state of the company during the financial year and so the declaration on the internal controls should fit with the period covered by the annual report and the accounts. It is not proportionate or necessary to require the internal controls statement to cover the stump period between the date of the balance sheet and the date of the annual report; this period would be covered by the statement included in the annual report the following year and that in our view is sufficient.

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?

We recognise that the internal controls referenced in the Governance Code as currently drafted cover financial, operational and compliance controls and are therefore broader than just financial controls. We also acknowledge that there should be systems in place in relation to non-financial reporting to ensure that investors and other stakeholders can rely on the information disclosed. However, as observed by the government in its guidance on the Regulations in relation to the external assurance of internal controls and the AAP, "Since companies' approach to internal controls relating to non-financial controls may be less developed, the provision in these regulations focuses on financial reporting."[2] We do not think therefore that the approach in the Governance Code should differ from the approach in the Regulations; due to the nascent nature of many companies' non-financial reporting internal control systems, these should not be held to the same standard as their financial reporting internal control systems. We support the drive to develop and improve standards over time but believe that these standards should be given time to develop and that it is too early to include non-financial reporting controls in the internal controls statement.

[2] See Section H of the guidance produced by the Department of Business and Trade on the Regulations

We also note that the scope of the government's mandate for the FRC in relation to internal controls (as set out above under Question 13) was limited to financial, operational and compliance systems. The proposed approach by the FRC therefore is wider than mandated.

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?

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?

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

With regard to Questions 16-18, our response is given in the context of not being preparers of reports and accounts and so our views are limited to general observations. In general, we would not object to guidance and definitions being developed, provided that any such guidance or definitions are sufficiently flexible and recognise the wide range of specific circumstances and contexts in which different companies will apply them. It would be unfortunate if the application of guidance by companies led to a convergence of practice and the development of a market accepted standard approach. This would fail to cater for the broad range of Governance Code companies.

<u>Going concern</u>

19. 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)?

The Consultation Paper in paragraph 72 acknowledges the cross-over between current provision 30 (new provision 31) and the going concern aspects of the proposed resilience statement[3] and states that Governance Code companies which have complied with the going concern statement in their resilience statement, will be viewed as compliant with current provision 30 (new provision 31). We agree with this approach. We suggest however that the FRC inserts a footnote into current provision 30 (new provision 31) to acknowledge this cross-over as has been proposed in relation to current provision 31 (new provision 32).

We also think that all Governance Code companies (regardless of where they are incorporated) should be directed to the resilience statement requirement for the purposes of making their going concern disclosures in current provision 30 (new provision 31), in the same way as they are in the proposed amendments to current provision 31 (new provision 32) with regard to future prospects.

[3] See new section 414CD(7) to be inserted into the Companies Act 2006 by regulation 4 of the Regulations.

Resilience statement

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

Given that the Governance Code (in current provision 31 (new provision 32)) already requires all Governance Code companies to include disclosures in relation to their prospects and viability, and in light of the potential for duplication between current provision 31 (new provision 32) and the aspects of the resilience statement, we agree with the approach proposed by the FRC in current provision 31 (new provision 32).

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

See Question 20 above.

SECTION 5

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

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

We would appreciate confirmation from the FRC in its response statement to this consultation that the remuneration committee retains discretion as to whether malus/clawback should apply. Confusion seems to have arisen following publication of the Consultation Paper as new provision 40 states that the annual report should set out "the minimum circumstances in which malus and clawback provisions could be used", whereas the commentary at paragraph 83 of the Consultation Paper instead refers to "the minimum conditions in which these would apply". We understand from our discussions with the FRC that it is not intended that the Governance Code is intended in any way to suggest that a company's malus and clawback policy should remove discretion as to whether to apply the provisions.

Given that malus and clawback provisions are, by their nature, to apply in the most serious of circumstances affecting the relevant company, we do not see the benefit of a disclosure in relation to whether malus and clawback provisions have been operated over a five-year period. To require such a disclosure is likely to result in standardised drafting, which we understand the FRC is seeking to avoid.

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

We support changes which will simplify reporting by removing duplication and standardised disclosures.

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

Pay ratio reporting remains a requirement under the directors' remuneration reporting provisions contained in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2018. Given the difficulties in providing meaningful quantitative disclosures, we

welcome simplification in this area and support narrative reporting (not necessarily in the directors' remuneration report) as to how companies are supporting diversity both in the workforce and at board level.

We hope that this feedback is received in the spirit in which it is intended; not as criticism of the FRC but as honest, candid views provided to help contribute to the creation of a proportionate disclosure regime under the Governance Code. We are very grateful for the manner in which the FRC has conducted the consultation process and we have sought to address our concerns frankly to help ensure that the outcome of the consultation delivers the changes needed to improve the Governance Code further and drive the improvements the FRC, companies and other stakeholders wish to achieve.

If recent reports in the media are correct, we note with disappointment that the primary legislation required to create and empower the Audit, Reporting and Governance Authority (**ARGA**) will not be included in the King's Speech in November 2023. This will leave a gap in the reforms and prolong the reform implementation process. However, we hope that the delay in the parliamentary timetable will enable further discussion and debate on certain of the proposed reforms, most notably the proposal to grant powers to the ARGA to enforce directors' duties, in relation to which we have particular, significant concerns (which we believe are shared by a number of other stakeholders), which we have raised during the consultation process. We hope that this additional time can be used to continue the constructive conversations in which we have been engaged so that any reforms that are ultimately implemented in these areas will be appropriate, evidence-based and proportionate.

We would be delighted to engage with you further on these proposals.

Yours faithfully

Herbert Smith Freehills LLP