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UK Corporate Governance Code - Consultation document of May 2023 ("CGC2023")
Comment from the Share Plan Lawyers Group ("SPL")

This letter contains the comments of SPL on CGC2023. SPL was formed by lawyers whose main practice is employee share plans. SPL has more than 290 members, representing some 70 law firms, and a number of specialist practitioners. Our members include senior lawyers from the major UK firms.

One of the principal objectives of SPL is to discuss matters of interest with public and private sector bodies and, where appropriate, to lobby on behalf of members and their clients on issues affecting employee share plans.

Given SPL's role, we have concentrated on those elements of CGC2023 that relate specifically to employee share plans and incentive arrangements.

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

It is helpful that Provision 39 is to be amended to clarify that documents covering director remuneration should include malus and clawback provisions that would enable the company to recover and/or withhold sums or share awards.

We would suggest the following changes to clarify new Provision 40 and enhance transparency.

1. Scope of Provision 40

Provision 40 sets out the enhanced malus and clawback disclosure requirements, aiming to achieve greater transparency. The consultation paper indicates that the disclosure would be limited to the way malus and clawback apply to directors. In particular, paragraphs 80 and 81 of the consultation document refer to executive remuneration and withholding pay "from directors". Provision 39, to which the consultation paper refers expressly, is clearly limited to directors' pay.

However, Provision 40 does not mention directors' pay. There is no obvious link or cross-reference between Provisions 39 and 40, apart from the natural sequence. Provision 39 sets out the requirement to have powers enabling "the company to recover and/or withhold sums or share awards". Provision 40 sets out what a company should describe, presumably to show compliance with the structure requirement in Provision 39. However, Provision 40 has quite different language referring only to malus and clawback, without a link to directors' pay. Read in isolation, Provision 40 could have broader application (i.e. a requirement to describe the company's malus and

clawback powers and practice for the board and the wider workforce) and could also be taken to require non-executive directors' arrangements to include these provisions.

Provision 35 states that the remuneration committee should review workforce remuneration and related policies and the alignment of incentives and rewards with culture, and consider them when setting the policy for executive director remuneration.

In view of this, and in the current environment, it seems prudent to clarify the precise intended ambit of the disclosure requirements of Provision 40. We expect that the intention is to limit the disclosure to malus and clawback provisions applicable to executive directors' pay, rather than more broadly to workforce pay. We think that this should be expressed in Provision 40.

2. Period of malus and clawback

Provision 40 requires "a description of the minimum period for malus and clawback". Clawback applies after vesting so it is logical to set out expressly the period of time during which vested pay is at risk of demands for repayment. However, companies do not generally set "malus periods" as such. Malus refers to what is, in effect, the lapsing or forfeiture of an award, in whole or in part, before the award vests due to the relevant circumstances. Accordingly, the risk of malus would always end at vesting. It would be helpful to clarify what is expected when disclosing a malus period since remuneration reports already disclose when a performance or service condition period would end, in the normal course. In practice, it may be that the intention could be achieved (subject to our further comment below) by a reference only to the "clawback" period.

In addition, we are not certain what is meant by a "minimum" period. Generally, the periods set are fixed and, certainly for malus, end at the point of vesting which would normally be shortly after the end of the performance period. It is also the case that companies frequently have the power to waive clawback periods and, in some cases, the clawback period may cease to apply on an event, such as a change of control of the company. We presume that provisions such as these ought to be disclosed as contingencies that might accelerate the expiry of a clawback period.

Finally, there is a proposed requirement to explain why the period is suited to the company's circumstances ("best suited to the organisation"). There is no similar requirement to explain why the particular malus and clawback triggers have been chosen or are so suited. Requiring companies to explain why they have chosen a particular period is not likely to elicit any useful information when most will follow market practice. We suggest that this additional proposed requirement is dropped.

3. Disclosure of past use of malus and clawback

The last sentence of Provision 40 states: "Companies should set out the use of their malus and clawback provisions in the last five years". The footnote says that the Board Effectiveness Guidance will include "further guidance on the suggested format".

Our view is that the proposed disclosure requirement is unnecessary. It is substantially repetitive of pre-existing disclosure obligations (at least for UK incorporated companies).

If the requirement were to remain, in one form or another, our comments are that:

- There should be a proviso that no disclosure need be made that would otherwise, in the opinion of the board, involve the disclosure of commercially sensitive information.
- The five year disclosure requirement should apply only from the first reporting period to which the revised Code will apply (i.e. from 1 January 2025). Otherwise, companies would have to review retrospectively five years of conduct in relation to malus and clawback.

- Former directors should, presumably, be omitted.
- The potential duplication between the five year disclosure and the separate requirement in Provision 40 to disclose "whether the provisions have been used in the "last reporting period" should be eliminated. We take it that what is meant by "last" is the financial year being reported on.

These matters could be clarified either in Provision 40 itself or in the revised Board Effectiveness Guidance. It is also not clear if the Guidance will be issued in draft with the ability to comment on proposed wording.

Additional comments on the Code

We would like to take this opportunity to make two additional comments which are not strictly covered by the terms of this consultation:

(a) **Renumbered Provision 38**

This Provision states that "…share awards granted for this purpose should be released for sale on a phased basis…". In practice, long term share awards are granted and, in the normal course, vest on a (regular) phased basis. Once vested, and subject to meeting any holding period requirement, the award holder is usually free to retain or dispose of the shares subject to the usual regulatory restrictions (such as UK MAR and any related dealing policy adopted by the company). We suggest that the drafting of Provision 38 be amended to reflect the phased grant and vesting of awards, rather than the release of shares for sale.

This strikes us as a straightforward opportunity to remove a drafting anomaly.

(b) **Renumbered Provision 36**

This Provision states that "Remuneration for all non-executive directors ("NEDs") should not include share options or other performance-related elements." In the context of the debate about the remuneration of boards and the impact that this may have on the attractiveness or otherwise of the London Stock Exchange to companies considering a flotation, we wonder whether this prohibition should be reconsidered. We do not have a position on this, as such, but point out that the grant of options to NEDs is common in the US and that, separately, the Investment Association recognised in their letter to remuneration committee chairs in November 2022 that NEDs' fees have not generally kept pace with NEDs' responsibilities.