Response to the UK Corporate Governance Code Consultation

13th September 2023

Dear Mr. Styles,

Russell Investments values the chance to provide feedback on the UK Corporate Governance Code Consultation Document, published by the Financial Reporting Council (FRC).

Russell Investments is a global investment firm founded in 1936. Today, it is headquartered in Seattle with operations in the EMEA, North America and Asia-Pacific regions. Russell Investments provides investment management, advisory and implementation (execution) services. As of December 31, 2022, we had over 1,300 associates supporting this delivery and global assets under management (AUM) of USD 276.5bn. Our business is built on the partnerships we develop with our clients, helping them achieve their objectives.

We commend the FRC for its longstanding leadership in shaping the UK's Corporate Governance Code over numerous years. The UK Code is frequently seen as a benchmark for the utmost corporate governance standards. Many other markets look to it as a model as they undertake continuous reforms. Consequently, updates to the UK Code are expected to exert a substantial influence on corporate governance norms worldwide.

Section 1 – Board leadership and company purpose

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

We welcome the greater emphasis on outcomes; however, there is a need for additional clarification regarding what constitutes an outcome resulting from a governance activity, especially concerning Principle D.

Additionally, when a company is reporting a departure from the Code, we recommend elevating the significance of offering a transparent and substantive explanation that connects the deviation to its ultimate impact and results.

Concerning Provision 3, there is also a requirement for greater clarity regarding the outcomes of engagement. We anticipate that companies should not only report on these outcomes but also outline the actions taken to mitigate or address them effectively.

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 concur with the mention of environmental and social concerns in Provision 1. However, we firmly believe it is imperative to stipulate that companies must report on these matters only when they are financially material. Our objective is to encourage companies to pinpoint environmental and social issues that could impact their financial performance. They should elucidate why and how these aspects are factored into their strategic execution, including any climate-related objectives and transition strategies where applicable.

Furthermore, we express caution regarding the omission of the term "governance." The governance of sustainability plays a pivotal role in fostering accountability, transparency, efficiency, and adherence to the rule of law across all tiers. It facilitates the effective management of human, natural, economic, and financial resources to foster equitable and sustainable development, while also ensuring the participation of civil society in decision-making processes.

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

In the last few years, as a result of restrictions imposed during the COVID-19 pandemic and of the shifting preferences of companies and shareholders, the manner for holding shareholder meetings has evolved.

The G20/OECD Principles of Corporate Governance, as revised in 2023, include a new recommendation that acknowledge the growing relevance of remote participation in meetings as well as the need for legal frameworks to ensure equal access to information and opportunities for participation of all shareholders, regardless of how shareholder meetings are conducted. The new sub-Principle II.C.3 provides that "General shareholder meetings allowing for remote shareholder participation should be permitted by jurisdictions as a means to facilitate and reduce the costs to shareholders of participation and engagement. Such meetings should be conducted in a manner that ensures equal access to information and opportunities for participation of all shareholders." Currently, we feel the code fails to address this.

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 are pleased to see the inclusion of language explicitly highlighting directors' commitment to the annual board evaluation. To further enhance this, we propose that companies should also disclose their internal processes for assessing directors' contributions to the board. In our experience, many companies' justifications in this regard are lacking, often relying solely on attendance records at board and committee meetings as the basis for evaluation.

While many jurisdictions have established general requirements or recommendations for the qualifications of all board candidates, some jurisdictions place greater importance on achieving a balanced composition of skills, experience, and knowledge within the board as a whole, rather than focusing solely on the qualifications of individual board members. The introduction of a skills matrix in UK reporting would provide valuable support for assessing and promoting this approach.

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 welcome the language regarding the appointment of multiple directors in Provision 15, as well as the requirement for directors to dedicate ample time to fulfil their duties effectively. In terms of disclosure, it would be beneficial to provide details about the quantity and types of directorships held, private or listed companies, including any obligations pertaining to non-profit entities like charities. We recommend further clarification regarding the definition of "significant" concerning director appointments.

We appreciate the enhanced language concerning the appointment of multiple directors as outlined in Provision 15, as well as the stipulation for directors to commit sufficient time to fulfil their responsibilities competently. With regards to disclosure, it would be advantageous for companies to provide information regarding the number and nature of directorships held, whether they pertain to private or publicly listed companies, and if any obligations extend to non-profit organisations such as charities. We propose that additional clarification be provided concerning the specific criteria that constitute a directorship being deemed "significant."

Section 3 – Composition, succession and evaluation

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

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?

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

We acknowledge the expanded inclusion of 'diversity and inclusion' within corporate boards as a means to enhance the depth of board discussions and subsequently improve the quality of board decisions. Nonetheless, we advise against eliminating the specific mention of 'gender', even though there is a reference to gender balance in Principle 24 concerning senior management. A significant boost is expected with the new EU Directive to improve gender balance amongst directors of listed companies, setting quotas for large, listed EU companies (more than 250 employees). While we commend the UK's achievement in reaching 40%

female representation on corporate boards in FTSE 350 companies, we believe it's crucial to maintain momentum.

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 endorse the incorporation of recommendations outlined by the Chartered Governance Institute around the effectiveness of independent board evaluation in the UK listed sector.

We value the reinforcement of the language in Provision 24, which mandates an external board performance review every three years. It is important that the board not only discloses the process for conducting this review but also, to the extent possible, any significant findings and subsequent actions taken in response to these findings.

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?

We agree that all Code companies should develop an Audit & Assurance Policy (AAP) on a comply or explain basis, which includes providing information on the reason for the kind of audit and assurance services chosen. We support the publication and review of the policy every three years, along with an annual implementation report. We also concur that the Audit Committee should be in charge of creating the AAP and overseeing its execution.

We also agree that more dialogue between audit committee members and shareholders could be encourage. In this instance we would suggest mentioning outcomes and actions taken following engagement to better align with the previous provisions of the code.

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?

Consistent with good global governance practices, we agree that Code companies should apply the Minimum Standard for Audit Committees.

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?

Along with financial reporting standards, we support mandatory sustainability reporting requirements. In order for investors to accurately assess and value sustainability-related risk, opportunity, and resilience in investee companies, thorough, consistent, and comparable corporate sustainability reporting will help make this possible.

We support more uniformity between financial statements and disclosures related to sustainability, particularly regarding the effects of climate-related transition plans. While we concur that it may also be appropriate for the Audit Committee to oversee the company's approach to corporate sustainability reporting and assurance, we would not necessarily give the Audit Committee this duty. Some businesses have ESG/Sustainability committees, which may be better suited to do this job. From this vantage point, we advise letting the decision be made by the board of directors.

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?

We fully support the proposed amendments in the Code, which aim to reinforce the emphasis on the efficiency of risk management and internal control systems.

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?

We also support the requirement for boards to affirm their implementation and maintenance of effective systems, ensuring the achievement of expected outcomes. This enhances accountability for the company's risk and internal control framework.

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 support the FRC's recommendation to substitute 'financial' with 'reporting,' as it broadens the scope of risk management to encompass sustainability-related factors essential for a company's long-term success and value generation.

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?

These disclosures should be aligned with globally recognised standards for internal auditing and undergo regular assessments. It is crucial to recognise that different companies may have varying levels of maturity and sophistication in their risk management and internal control mechanisms. Therefore, we strongly recommend that companies steer clear of using generic or boilerplate statements and instead strive for comprehensive and tailored disclosures that encompass all dimensions of their business risks.

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 proposal at this point.

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

No other areas identified.

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)?

We agree that Provision 30, which requires corporate boards to state whether they are adopting a going concern basis for accounting, should be retained in the Code.

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

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?

We support the FRC's approach, which mandates all companies to include 'future prospects' reporting in their annual reports, as outlined in Principles 32. We are of the opinion that this approach offers ample adaptability for non-public interest entities to report on the same under a comply or explain approach.

Section 5 – Remuneration

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

We welcome the incorporation of explicit language within Principle P, which integrates environmental, social, and governance (ESG) objectives into a company's long-term strategy, linking them with remuneration outcomes. However, we think the link between sustainability and compensation should be made only when ESG objectives have been defined as a Key Performance Indicator (KPI) by the company. From that perspective, we disagree, and we do not believe the compensation committee should necessarily ensure that rewards are linked with sustainability-related risk and opportunities.

We embrace the inclusion of the workforce in the drafting process. CEO and executive remuneration should be both fair and reasonable in structure and magnitude, rooted in the company's purpose, values, and strategic objectives. When establishing compensation levels, we advocate for Remuneration Committees to consider the pay levels of the average company worker and their relation to the median income in the company's home jurisdiction. The rationale behind individual compensation levels should be disclosed, along with their alignment with the broader context of the company's human resource strategy.

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

We agree with the inclusion of malus and clawback provisions in Provisions 39 and 40, which serve to guarantee that remuneration benefits can be retained or retrieved in cases where performance targets are not met or instances of misconduct, or misrepresentation. Additionally, we appreciate the mandatory disclosure requirements outlining the conditions under which these measures can be enforced. Although further guidance to determine the triggers would be welcome.

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

We retain no concern over the changes proposed to Provisions 40 and 41

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

The Remuneration Committee should continue to provide and explanation in the annual remuneration report and address any concerns of pay ratios and pay gaps.

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?

While AI offers numerous benefits to corporate governance, it also comes with challenges, such as ethical considerations, data privacy concerns, and the need for robust cybersecurity measures. Companies must strike a balance between harnessing AI's potential and managing associated risks to maximize its positive impact on corporate governance.

To address these challenges, and an area where the Code can focus on, organisations should prioritize ethical AI practices, invest in data governance, provide ongoing AI training, and establish clear policies and procedures for AI deployment.

QUESTIONS?

Contact **Russell Investments Active Ownership**