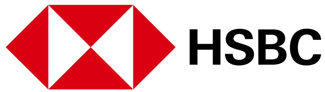

Financial Reporting Council
8th Floor
125 London Wall
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EC2Y 5AS

13th September 2023

BY EMAIL

Dear Sir/Madam

HSBC Holdings plc: Response to UK Corporate Governance Code Consultation

I am responding on behalf of HSBC Holdings plc ('HSBC'), which is one of the largest banking and financial services organisations in the world with listings in London, Hong Kong, New York, and Bermuda. We are committed to the highest standards of corporate governance and continually seek ways to enhance our corporate governance practices and procedures to support the Board's ambition of world-class governance.

We welcome the opportunity to share our views with the FRC regarding the proposals set out in its consultation of 24th May 2023. Summarised below are our overall messages and approach to responding to the consultation, which should be read in the context of the broader governance and regulatory reform agenda under the UK Government's objective of maintaining the UK's competitiveness as a global financial centre.

Our detailed responses to the consultation questions are set out in the Appendix. If we have not provided a response to a particular question, it means we have no substantive comments to make on that question.

We have also contributed through our membership of industry bodies, including the GC100, the Corporate Governance Institute and UK Finance and our participation in working groups established to consider the Code consultation. We endorse and support the broader perspectives raised through their respective responses to the consultation.

Overall messages in response to the consultation

We are supportive of the UK Government's efforts to promote the attractiveness of the UK as a global financial centre and believe that the Code is an important element of the UK's appeal, contributing to the UK's reputation for high standards of corporate governance. It will be important that the revised Code is seen to be positively contributing to the attractiveness of the UK as a listing destination.

HSBC notes that the Code consultation is currently one of a number of reforms under consultation impacting UK listed companies and would encourage the FRC and other policy setters (including those in Government) to be mindful of the demands that the review and implementation of these

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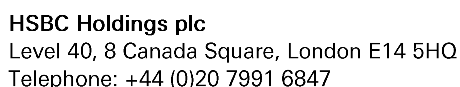
reforms will place on UK listed companies. It should be noted that Financial Services groups in particular are already subject to increased regulation and rule-setters and regulators should be encouraged to leverage equivalent regimes and/or existing standards rather than create parallel regimes (eg it could be beneficial to use equivalence regimes that allow entities to incorporate regulatory approaches or requirements of other listing authorities such as US Sarbanes Oxley (‘SOX’)) and avoiding provisions in the Code that are duplicative of requirements to which UK listed companies already adhere. We would encourage the FRC to also be mindful of the views of other regulators as part of the consultation process.

The primary changes to the Code that are proposed through this consultation are long-awaited and address the proposals related to the UK Government’s response to Restoring Trust in Audit and Corporate Governance. However, we want to ensure that you are aware of some of the key concerns we raised in our response to the Restoring Trust in Audit and Corporate Governance consultation in July 2021 . In particular, HSBC notes that the broader changes proposed to the Code place additional responsibility and disclosure obligations upon listed companies and their directors and in some instances go beyond the changes envisaged as part of the Government reforms. The proposed changes would augment directors’ responsibilities and will also increase costs (particularly assurance costs) for companies in order to enable directors to meet those additional obligations.

We note that more detailed guidance to complement the revised Code will be published in due course and would ask that our responses are caveated in this regard. We would encourage the FRC to refrain from issuing overly prescriptive guidance and allow greater flexibility to individual companies in the approach to implementation of the various corporate governance requirements. It is important that the Code is both flexible and proportionate given the variety of companies, industries, and circumstances covered by those who are subject to the Code. Furthermore, we would welcome efforts by the FRC to consolidate existing guidance where possible, particularly on matters such as audit, reporting and corporate governance, in order to make the guidance more user-friendly and to promote compliance.

We would welcome the opportunity to engage with you directly to discuss some of the key aspects raised through our response. Please contact me if any further information would be helpful.

Yours faithfully
for and on behalf of HSBC Holdings plc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Appendix

UK Corporate Governance Code Consultation - Detailed Responses to Questions

Section 1 – Board leadership and company purpose

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?

Given HSBC's strategy, of which the "transition to net zero" is a key pillar, we already report on this basis and therefore have no specific concerns with the proposed change.

However, we would question whether it is necessary to build this reporting into the Code given other sustainability and ESG related disclosure requirements that companies are, and will be, subject to. If the FRC decides to proceed with this change, we would encourage the FRC to provide companies with flexibility relevant to determine whether climate ambitions and transition planning are material according to their specific strategy and context.

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

There are two changes which we would encourage the FRC to consider further:

1. The consultation proposes that committee chairs "engage" with shareholders, as opposed to "seek engagement". In practice, due to resource and capacity constraints, investors are unable to fulfil requests from all companies and often need to prioritise which companies and topics on which to engage. We would encourage the FRC to retain the existing wording, reflecting that the relationship with investors and companies is two-way.

2. In relation to the proposed responsibility for the review of whistleblowing arrangements, we would encourage the FRC to avoid mandating where oversight of these arrangements should reside. We would instead ask the FRC to allow companies the flexibility to determine the appropriate forum where responsibility should sit according to their specific company circumstances. As a regulated financial services group, oversight of the Group's whistleblowing arrangements is delegated to the Group Audit Committee, with the chair designated as the whistleblowing champion. We, and others, would request that the Code allow companies the choice of retaining the current structure of our oversight arrangements, which we believe is in line with market practice for this sector.

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 supportive of the proposed change given individual director contributions, including their time commitment and other factors such as independence, are already considered at the time of appointment and as part of the annual board and committee performance review.

However, we would encourage the FRC to consider defining which of a director's external roles are to be considered by companies under this requirement. As an international banking group, we are subject to differing stakeholder expectations in relation to external commitments, including those of regulators, investors, and proxy agencies. We would encourage the FRC to avoid creating further standards, and unintentionally creating additional work for listed companies, and confusion for shareholders and stakeholders.

For example, one approach might be to align with the equivalent approach under Listing Rule 9.6.13, whereby companies are required to disclose appointments in any other publicly quoted company.

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 are not supportive of this amendment to the Code, which we consider to be overly prescriptive, would be of limited value, and be likely to lead to boilerplate disclosure.

Our view is that the current Code wording remains appropriate. Boards, in particular the Chair, should be trusted to ensure that all directors are able to commit sufficient time to the effective discharge of their role, and any issues should be identified for remediation as part of the annual effectiveness review.

As per our comment under question 4, we would encourage the FRC to consider the definition of which external roles are to be considered by companies under this requirement.

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?

We are broadly supportive of the proposals, with the exception of two points:

1. Our view is that boards should consider a director's other commitments on an ongoing basis, rather than at a point in time, with the revised Code proposing that this be done as part of the annual performance review. We would require that directors should raise potential additional appointments, and the implications on their time commitment and other factors such as independence, with the Chairman and Company Secretary in advance of accepting any other position; and

2. We consider that a number of the proposals around diversity are duplicative of the FCA Listing Rules. We have provided further comment on this as part of our response to question 8 below.

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?

We are supportive of the proposed changes but would encourage caution in relation to the requirement to report on “non-visible” characteristics given the small size of boards.

We need to remain mindful of the personal privacy of directors and this may lead to a greater number exercising their right to “prefer not to say” given the risk that disclosure could enable the readers of reporting to determine which directors have self-identified as an underrepresented characteristic.

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 are broadly supportive of the proposal, dependent upon the level of detail that companies will be expected to disclose. Succession planning decisions require strict confidentiality and we would not be prepared to disclose details on plans that could lead to unnecessary internal and external speculation.

We would also suggest that the requirement to explain how the nomination committee has overseen the “development of a pipeline” for succession be updated to reflect that in practice this is more relevant for executive appointments (including executive directors) as opposed to non-executive director succession. In our experience, the availability of board succession candidates is dependent on the market at the time and the availability of “pipeline” candidates is limited given that most have a portfolio of directorships.

In relation to the fourth bullet of the revised provision on reporting on diversity of senior management and their direct reports, this is duplicative of existing reporting including under the FTSE Women Leaders Review and the FCA’s Listing Rules. There are different terms and scopes for these populations, which causes duplication and complexity for companies, for example the Code definition of “senior management”, the FTSE Leaders Review definition of “executive committees” and the Listing Rule requirement of “executive management”. We would encourage the FRC to work with others to move towards the adoption of consistent definitions and common themes for reporting.

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 are supportive of the proposed adoption of the CGI recommendations on the basis that these are sufficiently high-level and therefore will continue to provide companies with flexibility around how to conduct their performance reviews.

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 with the requirement for producing an Audit and Assurance Policy, noting that this is already a proposed requirement for Public Interest Entities (‘PIE’) such as HSBC Holdings plc. We note that the Department for Business & Trade published draft regulations on new company reporting requirements on 19 July 2023, which the FRC intends to provide guidance on. Further development of the associated guidance will be helpful in determining the

appropriateness of expanding the scope to include all Code companies, together with the development of market practice. However, it is less clear what a comply or explain approach means in the context of the Audit and Assurance Policy as the requirements will not mandate additional assurance but rather set out what assurance companies will seek.

We also note the proposed requirement that the audit committee engage with shareholders on this policy and the role of the audit committee. In line with our response to question 3 above, we would encourage the FRC to amend this requirement to read "seek engagement" to reflect that engagement requires commitment and willingness from both parties, and to recognise that investors may wish to prioritise engagement on other topics or with particular companies.

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?

Cross-referring could remove duplication, although this means reference to multiple sources of information will be required in order to understand the requirements on audit committees. If the minimum standard will become "mandated" by reference from the legislation, it may be simpler to directly subsume it into a specific external audit provision.

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?

While supportive of continuing efforts to develop assurance of ESG metrics and monitoring the integrity of narrative reporting, including on sustainability reporting, we do not support the proposal that this should explicitly be the responsibility of the audit committee. We would encourage the FRC to provide companies with flexibility to determine the appropriate governance for oversight of ESG reporting.

Many companies use alternative governance forums to audit committees at the board level, as well as at the executive level, for oversight of ESG matters.

Further, the Code asks for audit committees to have relevant financial expertise and competence relevant to the sector in which they operate. The audit committee's primary role is around the integrity of financial reporting, internal controls (and where there is no separate risk committee), risk and compliance. As the ESG scope is broader and rapidly evolving, it may not always be appropriate for audit committees to consider these matters or opine on them and the proposed change may have implications for the composition of the board and the audit committee specifically. Even with the right expertise in place, including narrative reporting in the audit committee's responsibilities would be a significant expansion in scope and would potentially negatively impact the time the audit committee has available to review items.

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 are supportive of the requirement for a review of risk management and internal control systems, but it is difficult to assess proportionality without the planned supporting guidance.

Specifically, the following areas could have a significant impact on the cost and effort to support the required declaration:

1. The definition of “all material controls” could potentially bring many thousands of controls into scope for large complex businesses, especially with reference to “operational” and “compliance” controls which implies a very wide-ranging assessment, well beyond those that directly support financial reporting activities. The inclusion of “compliance” specifically could greatly increase the scope for highly regulated financial services companies with a large volume of compliance related processes and controls.
2. Similarly, the definition of “material weaknesses or failures identified” is critical to ensure only the most important and relevant issues are disclosed to end users. With the potentially wide scope of reporting and relevant controls, an imprecise definition of “material” could result in the unintended consequence of large volumes of control related issues being disclosed, which may have a negative effect in terms of understanding context, priority, and impact.
3. Further clarity would be beneficial regarding the expected role of external auditors in independently assessing the board’s declaration on internal controls, for example, whether external auditors will be required to conduct dedicated and additional assurance work on broader internal controls.

There are existing definitions of ‘material’ in other frameworks, most notably the Sarbanes-Oxley requirements in the US and understanding how the two may or may not align will be key to the efforts required in organisations required to apply both frameworks.

Please also refer to the answers to questions 14 and 15 which cover specific aspects on “continuous monitoring” and coverage of narrative reporting which may also have a significant impact on proportionality.

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?

The date of the balance sheet is preferred for the declaration. The principle of “continuous monitoring” is appropriate based on current risk management practices and is typically a core part of relevant frameworks. However, the implication of basing the declaration on continuous monitoring could imply a much wider disclosure of results than is helpful for end users (depending on how this interacts with the definition of materiality). This may also have a negative effect on the willingness to self-declare issues if these could automatically become disclosable, regardless of root cause, efforts to suitably remediate or implement compensating procedures.

Setting a clear “as at” date for the declaration creates a useful practical focus for undertaking a full evaluation of potentially material issues, especially in the context of compensatory controls or other mitigating activities undertaken. This allows a higher quality disclosure in order to accurately present the impact.

Further, with no “as at” date there would be practical issues regarding how late would be too late for information to be included in the annual report. This could lead to omissions, rushed inclusions, or delayed reports.

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?

The intention to include the narrative sections of reporting in-scope of the declaration is appropriate. This will require specific consideration in the related guidance for a more differentiated approach for such reporting, such as on the definition of material weakness which is typically primarily quantitatively driven. Please refer to our response under Q13 above.

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?

As highlighted by the FRC throughout its engagement on the proposed changes to the Code, banking and financial services companies have existing and well-established processes around effective internal controls and risk management.

Example frameworks may be helpful, although the benefit may be limited if these are too generic or theoretical. More value could be provided with direct reference to existing standards and practice in the UK, whilst not limiting the flexibility and discretion available to companies.

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?

Please refer to our responses to questions 13 – 16 above.

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

In addition to the responses to the previous questions, guidance on the following areas would help with implementation of the requirements:

- Clarity on the scope of reporting covered by the requirements, with appropriate differentiation in undertaking the review of controls and assessing deficiencies between quantitative financial information and other more qualitative reporting;
- Practical guidance on defining when a control is deemed “material”;
- Expectations on the approach to determining if a deficiency is a “material weakness or other failure”; and

- The expected extent that independent assurance procedures (internal or external) should be undertaken to support the declaration in relation to risk management and internal controls, or whether self-assessment is sufficient.

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, going concern and reporting on future prospects are linked so the current provision is worth retaining. This supports consistency across Code companies and sets the expectation of disclosing more detail on the going concern assessment than required under accounting standards. This consistency is also positive for non-PIEs, assuming a continuation of current practice meets the requirement.

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

Yes, this should continue as going concern and reporting on future prospects are interlinked, and the continued requirement supports consistency.

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?

The proposed revisions do not represent a significant change, and in practice a proportionate approach is already followed. The removal of the period of assessment requirement is helpful.

Section 5 – Remuneration

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

We are broadly supportive of the changes, and we, as well as many other companies, already disclose the link between executive pay to the delivery of E, S and G goals.

However, it is important that companies have flexibility regarding the choice of metrics that form part of executive director incentives given the need to ensure that these support the delivery of long-term sustainable value and strategy for individual companies and their stakeholders.

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

We would recommend the provision to focus on outlining the purpose of incorporating malus and clawback policies in a remuneration structure. This will offer guidance to companies to

design policies that are most appropriate for the business to ensure recovery of remuneration during an event.

Rather than having a standard one-year disclosure format, the Code could set out expectations of disclosure requirements when an application of malus or clawback occurs during a financial year. This will help improve the quality of remuneration-related disclosures without adding disclosures in a year where malus or clawback does not take place.

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

We are supportive of the proposal to remove this requirement.