Chartered Governance Institute UK & Ireland

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By email: codereview@frc.org.uk.

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Dear Maureen,

Financial Reporting Council – UK Corporate Governance Code Consultation

We welcome the opportunity to comment on the Financial Reporting Council (FRC)'s consultation on amendments to the UK Corporate Governance Code (the Code).

As you know, the Chartered Governance Institute UK & Ireland is the professional body for governance and the qualifying and membership body for governance professionals across all sectors. Its purpose under Royal Charter is to lead effective governance and efficient administration of commerce, industry and public affairs, working with regulators and policymakers to champion high standards of governance and providing qualifications, training, and guidance. As a lifelong learning partner, the Institute helps governance professionals achieve their professional goals, providing recognition, community, and the voice of its membership.

One of nine divisions of the global Chartered Governance Institute, which was established 130 years ago, The Chartered Governance Institute UK & Ireland represents members working and studying in the UK and Ireland and many other countries and regions including the Caribbean, parts of Africa and the Middle East.

As the professional body that qualifies Chartered Secretaries and Chartered Governance Professionals, our members have a uniquely privileged role in shaping and administering companies' governance arrangements. They are therefore well placed to understand the issues raised by this consultation document. In preparing our response we have consulted, amongst others, with our members. However, the views expressed in this response are not necessarily those of any individual members, nor of the companies they represent.

Our views on the questions asked in your consultation paper are set out below.

General comments

The corporate governance landscape is constantly evolving and periodic corporate failures serve as poignant reminders of the vulnerabilities entrenched within corporate frameworks.

It is very easy to attribute the failure of an organisation to 'governance failure' and, in some cases, this may be true. But not always, and the Code plays an important role in guiding companies toward responsible conduct, transparency, and accountability.

The FRC's proposed alterations to the Code are, in many respects, a proactive response to these failures and a recognition that good practice is not set in stone. That said, it is important for the detail to offer practical help for companies to improve their governance and yet avoid unnecessary complexity.

There are many siren voices arguing for a watering down of UK legislation and regulation in the interests of attracting more companies to list in the UK and of slowing the drift away from public listing. While these are laudable goals, changes to UK legislation and regulation must be carefully considered in order to avoid any risk that the pendulum will be allowed, in response to what could be short-lived trends, to swing too far away from the strong governance structure that we believe is a significant advantage – indeed a USP - for the UK market.

The UK is already a strong governance environment in global terms and it is important that, in this environment, where there is a distrust of companies among some stakeholders (which, interestingly, is not aligned with the most recent Edelman Trust Barometer) the FRC is confident that any changes it makes to the Code add value and that their impact is not overly onerous, encouraging the micro-management of companies by either regulators or shareholders. It is fair to say that some of our members take the view that some of the proposed changes carry a risk of making the UK corporate environment overly-governance focused, increasing box-ticking and boilerplate. The text of the FRC's guidance will be enormously important in ensuring that this is not the case, and the Institute stands ready to assist with the development of appropriate guidance.

A number of themes have emerged in our response:

- The enormous respect for the value that the Code adds to the UK market
- The need to take advantage of technology to ensure that reporting can be kept up to date, though the use of the website rather than always through the annual report
- The pivotal role of company secretaries and governance professionals in corporate governance, and the importance of their specific expertise
- The need to ensure that materiality is a matter for the judgement of the board alone – only the board is in the appropriate position to judge what reporting is material to the company and what is not; allowing other stakeholders to second guess this, based on their own values and interests, is not helpful.

The ever increasing breadth and depth of required topics for disclosure can contribute to a rise in boiler-plate disclosures, in particular where companies feel obliged to report on issues which they believe are simply not material to their business. And boiler-plate disclosures are, we would suggest, of little use to anyone.

It is right and important that management attention is spent on reporting, but this should not unduly redirect attention away from business matters. One of the most striking findings from our recent Boardroom Bellwether survey was that 81% of respondents believe that, to some or to a large extent, increasing reporting requirements are having an impact on the time available to the board to discuss strategy.

That cannot be the intention. And it is essential that changes to the Code do not add to that burden.

Specific consultation questions

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

We agree with the FRC that the amendments to Principle D will deliver more outcomes-based reporting on the board's governance activities and we agree that incorporating the "comply or explain" principle into this approach is a good idea. Indeed, we would argue that it is essential. These measures will, in the long term, foster consistency and simplify monitoring.

However, some of our members feel that the FRC should clarify what "outcome-based" reporting means to achieve the intended results. Some members have argued that the current proposed wording of Principle D seems to suggest that annual reports must establish specific causal links between governance practices and outcomes, which can be difficult to predict and quantify. Moreover, some members were of the view that, although it is easy to explain principles and procedures, providing evidence of governance outcomes (which are sometimes unknown, in part due to their long-term nature) is more challenging and could make the reporting process too formulaic and cumbersome.

Consequently, companies may need some time to understand how to report on the outcome of their governance practices; this could result in boilerplate reporting during the early years. For this reason, we suggest that the FRC includes examples of how to comply with the new Principle D and clarifies the meaning of “outcomes-based reporting” in the guidance. To reiterate, the Institute stands ready to offer any help that we can with the development of this guidance.

Q2: Do you think the board should report on the company’s climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

Yes. We believe that companies should follow sustainability guidelines as they apply to their specific sector or circumstances. But each company is different and so may prioritise different aspects of sustainability, with some choosing to invest more upfront for long-term benefits. It is important for companies to be transparent about their plans for transitioning to a sustainable future and incorporate their climate goals into their strategy and governance, but it should be recognised that different companies will have different foci and that this is not a bad thing.

However, members expressed mixed feelings about whether this requirement should be included in the Code. Many believe that it is important for Code companies to lead the way by reporting on their plans and setting the standard for others and that it is crucial to establish industry standards for consistent reporting across companies. That said, others fear that adding this requirement could duplicate efforts already being made through other regulations and standards. There are already national and international regulations and guidelines promoting the incorporation of climate ambition and transition planning into a company's strategy and governance, such as the UK Sustainability Disclosure Standards published by the Department for Business and Trade (DBT). DBT has also just undertaken a call for evidence on non-financial reporting and it is important that FRC requirements and guidance chime with the outcome of that work and add no more than is absolutely necessary to the growth of narrative reporting in the annual report.

On balance, we believe that it would be helpful were the FRC to provide guidance on how and what companies should report. The alternative is to leave it to others to fill the vacuum, whereas FRC guidance would better enable companies to respond to reasonable expectations from stakeholders and regulators without confusion or ambiguity.

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

We have received comments from our members on Principles A and C and Provisions 3, 4 and 6.

Principle A

In relation to the inclusion of "necessary resources" in Principle A, our view is that the separation of the role of Company Secretary and General Counsel is necessary to afford appropriate support to the board in carrying out its overarching role as set out in Section 1. We recommend therefore that this separation be included in the forthcoming guidance.

Principle C / Provision 3

A significant number of our members believe that attempts at shareholder engagement can be ignored by those invited to participate and that this should be reflected in the wording of Principle C and Provision 3, as it was in the previous drafting of Provision 3, with the phrase **"should engage"** replaced by the term **"should offer to engage**", given that shareholder engagement by companies is contingent upon their willingness to participate:

> "C. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should **offer** effective engagement with, and encourage participation from, these parties
>
> "3. In addition to formal general meetings, the chair should **offer** regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. Committee chairs should **offer to** engage with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board has a clear understanding of the views of shareholders, and report in the annual report on the outcomes of the engagement which has taken place with them during the reporting period."

This wording recognises that companies can make efforts to facilitate engagement, but acknowledges that the onus should not rest solely on companies when shareholders might not actively engage. Moreover, the success of engagement hinges on shareholders' readiness to participate. For example, some members working in very large FTSE companies report that response from shareholders to opportunities to talk to the audit committee chair or members has been very poor, and if that is the case for these companies, it will be immeasurably worse for others.

Furthermore, in the absence of the 'offer' wording, companies would need to explain lack of engagement, which could lead to them naming and shaming shareholders who have refused to engage responsibly. Although some of our members would not see this as a bad outcome as not all those who talk publicly about engagement necessarily follow this through in practice, this would not be a desired outcome, and we believe that many companies would be reluctant to do this publicly.

There was a view expressed that the FRC could consider requiring shareholders to engage. However, this would necessitate a comprehensive revision of the Stewardship Code to grant it more authoritative power, effectively strengthening its influence. A number of our members argued, persuasively, that this is overdue and the Stewardship Code lacks effective enforcement and needs updating to recognise current investment market practice.

There is a potential for enhanced enforcement mechanisms to be established as the FRC transforms into the Audit, Reporting, and Governance Authority (ARGA). Given the importance of shareholder stewardship in the UK corporate governance structure, there should be more rigorous oversight from the regulator in situations where shareholders are not engaging as expected. The changing dynamic of the investor model means that although some shareholders and investment managers continue to see themselves as owners of a company with associated stewardship responsibilities, others see themselves primarily as investors, interested only in income and asset growth. Where shareholders who are signatories to the Stewardship Code decline to engage, we believe that companies should be expected to report this to ARGA.

Provision 4

Some of our members believe that the 20% threshold in Provision 4 is too low and should be raised to 40% for ordinary resolutions and also apply to any special resolution that doesn't pass. Their view is that the market has changed and that the register has lost a little of its effectiveness at this level. In return, they suggest that the "update on the views received from shareholders and actions taken" might reasonably be expected sooner than "no later than six months after the shareholder meeting." A period of six months after the AGM equates to approximately ten months after the year-end before shareholders receive an update on matters that concern them. In most cases, companies will have spent considerable time establishing the views of shareholders in advance of the meeting. However, shareholders do not always take the same view and, given the low threshold applied to this requirement, an adverse vote will rarely come as a surprise. This may be a matter for future consultation by the FRC.

Principle E / Provision 6

The old Principle E included a sentence "The workforce should be able to raise any matters of concern" which has been deleted in the new drafting as it is not carried over to the new Principle B. Whilst we understand that this issue remains covered in Provision 6, we believe that this is such an important issue that it should be subject to the 'Apply' requirements of a Principle, rather than the 'Comply or Explain' requirement of a Provision. Consequently, we believe that this sentence should be reinstated at the end of Principle B, with a minor amendment for clarity.

> "B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are all aligned. All directors must act with integrity, lead by example and promote the desired culture. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. **The workforce should be able to raise any matters of concern with the board.**"

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?

Yes, we agree with the proposed revisions to Code Principle K. A comprehensive board performance review process should include both an assessment of the board's overall performance and the individual directors' capacities to effectively fulfil their obligations, including their commitments to external organisations. Although concerns about overboarding in FTSE companies can be overstated, there are cases of overboarding, and this is an important issue which should be considered as part of a comprehensive board performance review.

The question of overboarding is a complex one, and there is an inherent challenge in prescribing a uniform approach to good practice in this arena. There is substantial variability in the time commitment required for each company and this is exacerbated when directors hold multiple positions, each with different time demands. Furthermore, board members often have other commitments which do not fall to be disclosed in annual reports – for example as charity trustees, school governors etc. For this reason, our members suggest that the FRC should

consider including in the guidance that the review should cover both whether the director concerned has been able to devote sufficient time in the previous year and whether they can be expected to devote sufficient time going forward.

In terms of specific wording of Principle K , we suggest substituting the term **"evaluation"** with **"performance review"** to capture the intent of the assessment more accurately and a minor change to tighten the wording:

> "K. Annual **performance review** of the board should consider its performance, composition, diversity and how effectively members work together. Individual evaluation should demonstrate whether each director continues to contribute effectively**, including their** commitments to other organisations and their ability to discharge their responsibilities effectively."

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?

Yes. However, our members have made a number of suggestions which we believe the FRC should address in guidance.

The most important of these is a need for greater clarity around what constitutes **"significant director appointments".** As noted above, there is substantial variability in the time commitment required for each company and this is exacerbated when directors hold multiple positions, each with different time demands. The FRC should define this term in guidance to ensure uniform interpretation.

There is an important balance to be struck between the potential overcommitment of an individual, meaning that they are unable to devote sufficient time to their board responsibilities, and the diverse experience that many of the most qualified Non-Executive Directors (NEDs) gain from participation on other boards. The current situation is unsatisfactory, as the disclosure requirement does not capture all roles which might take up a director's time, for example other, non-director, commitments such as academic posts, charity trusteeships and school governor roles, amongst others and, in any event, time commitments are rarely linear. For example, there is a huge difference in directors' commitment that arise when a company is involved in a corporate action, or experiences another major issue. Put together, there is a risk that excessive disclosure might deter valuable individuals from board roles.

There is already significant focus on overboarding and established ratios set by proxy agencies and institutional shareholders. If the intention is to extend disclosure beyond other public company directorships, this is likely to be viewed as unnecessarily intrusive by directors, with the result that it could deter them from taking on UK listed plc directorships or result in them withdrawing from the advice and support they often provide to the voluntary and charity sectors.

Our members also warned that this requirement might be challenging in practice. A company secretary drafting the governance report will need to rely on assurances from the director concerned regarding their time commitments elsewhere or from the company secretary of the other organisation(s). Not all companies will be as co-operative as we might hope in providing this data and it gets complicated if the director serves on companies with different year-ends (as many will do in order to manage the time commitments) as then the data kept by each company will be for different time periods. Whilst number of board or committee meetings is of interest, it is all the other work that can take the time, preparing for meetings, engaging with management between Board meetings, advising the chair on issues, readiness to attend ad hoc calls and participate in email exchanges when 'events' happen. None of this is currently captured by the current list of how many meetings were attended. Often, the ad hoc calls occur when something unexpected happens and the decisions made can be more significant than routine matters.

One other point that arose during our discussions was that the current Provision 15 makes specific reference to "Full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment. Some of our members suggested that often FTSE 250 commitments can be as time-consuming, and possibly more so as FTSE 250 companies are probably more likely to be involved in corporate actions requiring shareholder approval because of their scale. Furthermore, if the Code is to expand the remit of audit committees to include narrative reporting, including sustainability reporting and ESG metrics, as suggested in question 12 below, it is likely that additional meetings will be required to cover the extended responsibilities and the Code will need to be clear how this is reflected in the reporting of significant commitments. A NED who is Chair of Audit and Assurance will need to spend significantly more time on the appointment than a NED who is perhaps a member only of a Remco.

Finally, we believe that details of each director's appointments and commitments should be published on the company's website instead of in their annual report. A dynamic list on the company website is a more effective solution, enabling the continual update of information, reducing the reliance solely on the annual report. For listed companies, the disclosure of other listed directorships is already a mandatory practice via an RIS; extending this requirement to include updating the company website after such disclosures could ensure ongoing currency of information.

We would suggest amending Provision 15 as follows:

> 15 "All significant director appointments should be listed **on the company's website and** the annual report **should describe** how each director has sufficient time to undertake their role effectively in light of commitments to other organisations. This should describe any actions taken as a result of this assessment. When making new appointments, the board should take into account other demands on directors' time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional **significant** external appointments should not be undertaken without prior approval of the board, with the reasons for permitting significant appointments explained in the annual report. Full-time executive directors should not take on more than one non-executive directorship in a FTSE **350** company or other significant appointment."

In the same section of the Code, we have two further observations to make:

- A key issue not adequately addressed in the Code is the role of the company secretary, which comes to the fore in times of corporate stress, and it is vital that its independence is safeguarded to ensure that the role can be effectively discharged. If you are going to restore trust in governance then strengthening the role of the person who day to day is most responsible for governance in an organisation has to be a positive, and we believe that involves requiring that the role is independent of other executive responsibilities such as general counsel, finance executive or other role where conflicts of interest can easily occur, in the same way that no one would suggest that the role of an internal auditor be combined with that of a finance director.

  We have seen an increasing tendency for companies to adopt the US model of a combined general counsel / company secretary role or to have the company secretary report to the general counsel. We believe that this is poor practice and should be discouraged. Our members' experience is that, although the dual role model may work in some cases, particularly smaller companies or where the individual concerned is dual qualified, this does create a potential conflict of interest, where the responsibilities of each role differ, usually in times of corporate stress.

We therefore believe that it is an omission in Provision 14 that the role of the company secretary is not required to be set out in writing:

> "14. The responsibilities of the chair, chief executive, senior independent director, **company secretary,** board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors."

- For the same reasons, we do not agree with the view that we have recently seen expressed in the press, that the role of the general counsel should be formalised in regulation. We do not agree that lawyers are "fundamental to corporate governance". Like any other member of management, they should be instructed to join the board meeting to deal with specific issues.

> "16. All directors should have access to the advice of the company secretary, who is responsible for advising the board on all governance matters. **In order to ensure its independence, the role of the company secretary should report directly to the chair of the board in respect of all board matters and not to anyone who is not a board member.** Both the appointment and removal of the company secretary should be a matter for the whole board."

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

Yes.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

Yes. The wording of the new Principle I is well-crafted and future-proofs the framework against potential alterations in "protected characteristics". Moreover, the flexibility for companies that it introduces is a positive step. We appreciate the incorporation of protected and non-protected characteristics, extending beyond cognitive and personal strengths.

That said, we recommend that guidance should underscore the benefits of various forms of diversity, such as socioeconomic diversity. The guidance could ideally reference research and evidence that support these assertions, along with practical strategies to intelligently implement diversity initiatives.

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

Yes, particularly since the core content of the provisions remains unchanged. However, our members made the following observations:

- In the first two bullets of Provision 24, there should be a distinction between the internal and external pipeline of talent. This is because, in practice, the board or nomination committee typically oversees succession planning for executive board members like the CEO and CFO, fostering the development of a talent pipeline, whereas the CEO usually takes the lead in proposing succession plans for other senior management members, which then receive approval from the board or nomination committee to assure alignment with strategy. This alignment with corporate strategy ensures that senior management and executive board member succession plans effectively meet organisational needs.

It is important, also, to note that whilst the need to fill senior management positions can arise quickly with potentially short notice periods, new NEDs would be recruited externally and not from within the organisation and can be planned around the 3, 6 or 9 year terms of service. The process might, therefore, be more like 'we will need a new Audit Chair in year 5, so need to strengthen the Board with a financially experienced NED in year 2, who could take over as Audit Chair.'

We suggest an amendment to read as follows:

> First bullet point:
> "succession planning for both board and senior management positions, in order to deliver the company's strategy, including an explanation of how the committee has overseen the development of a diverse **internal and, as far as possible, external** pipelines for succession;"
>
> Second bullet point:
> "The appointments for the board and senior management, including the search and nomination procedures **for both internal and external talent,** and promotion of diversity;"

- In the fourth bullet point, we suggest broadening the provision to encompass all aspects of diversity within the organisation. Our members argued that inclusivity should extend beyond gender, where good progress has already been made, and be rooted instead in a more ambitious comprehensive diversity and inclusion policy that promotes opportunities for a holistic representation across the company. We suggest an amendment to read as follows:

> "The **diversity** balance of those in senior management and their direct reports"

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?

Yes.

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

Yes.

Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

Yes, we agree with the FRC's amendments to Provisions 25 and 26. We have two minor comments on Provision 26, which reflects our comment on Provision 3 above. Engagement is a two-way process and only practicable if both parties are willing. We therefore believe that Provision 26 should refer to the Committee 'offering engagement', rather than 'engaging'.

Similarly, we are persuaded by our friends at the Chartered Institute of Internal Audit that it would be helpful to have the establishment of an IA function specifically referenced in the Code. We would therefore propose the following minor changes to Provision 26:

Fifth bullet point:
"**offering engagement** with shareholders and other stakeholders on the role of the audit committee, the scope of work of the external auditor, and the approach to the audit and assurance policy;"

Tenth bullet point:
"**establishing and maintaining an internal audit function, as well as** monitoring and reviewing **its independence, objectivity and** effectiveness ~~of the company's internal audit function,~~ or**,** where there is not one, considering annually whether there is a need for one and making a recommendation to the board; and"

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?

Yes and no. The role of the audit committee has, over time, become increasingly complex. Alongside its traditional oversight of financial reporting, audit processes, internal controls, ethics and compliance programs, and external and internal audits, the audit committee is now entrusted with the additional responsibility of supervising critical risks such as cybersecurity and environmental, social, and governance (ESG) reporting.

However, we do believe that there is a risk of overextension of audit committee responsibilities. While it is good to see additional oversight of these issues, some of our members cautioned that excessively broadening the audit committee's role could lead to dilution. Audit committees already have a lot of important work to do and, as noted in our response to question 5 above, if the Code is to expand the remit of audit committees to include narrative reporting, including sustainability reporting and ESG metrics, it is likely that additional meetings will be required to cover the extended responsibilities and the Code will need to be clear how this is reflected in the reporting of significant commitments.

Our members also flagged one minor but important suggestion on the text. While outlining the audit committee's role in addressing narrative reporting on sustainability and ESG metrics may suit certain companies, this will not be the case for all companies. Some, particularly larger ones, may have already established or might opt for a distinct board committee dedicated to these matters, such as a sustainability committee, where independent NEDs can be given specific support. This reflects the treatment of risk issues in the Code. Consequently, we believe that the second bullet point of Provision 26 should recognise this:

> "Monitoring the integrity of narrative reporting, including **sustainability matters, except where this has been delegated to another board committee,** and reviewing any significant reporting judgment."

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal control systems proportionately?

To some extent, yes. The new Principle N, which now makes boards responsible not only for "establishing" but also "maintaining" an effective risk management and internal control framework, is proportionate, aligning with the evolving landscape of governance expectations. However, a number of members raised concerns about the impact of these changes on stakeholder, including shareholder, expectations. In particular, some of our members whose companies are dual-listed and so have experience of Sarbanes-Oxley legislation in the United States have emphasised the significant increase in monitoring work that this entails. Whilst we note the many statements made by the FRC that it is not their intention to create a 'SarbOx-Lite' model and that the changes are intended only to emphasise the existing obligations, this may not be the expectation of some stakeholders. Use of the phrase "all material controls" in Provision 30 offers some comfort, but greater emphasis that materiality is in the view of the board, not of other stakeholders would be helpful here.

Our response to question 15 below addresses the issue of financial and reporting controls, but our suggested wording for Provision 30 is:

"30. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all ~~material~~ controls **that, in the opinion of the board, are material,** including **financial,** operational~~, reporting~~ and compliance controls. The board should provide in the annual report: …"

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?

Our members have emphasised the importance to good reporting of establishing a clearly-defined cut-off point. Continuous monitoring, whilst superficially an ideal solution, presents significant practical challenges in this regard, not least that actual or potential issues sometimes take time to come to light. Most companies will incur a significant additional cost burden from implementing additional procedures to support Board requirements that are needed to underpin a continuous monitoring approach throughout the reporting period. This will be exacerbated by the fact that this does not align by the approach taken in other jurisdictions which, we are told, typically focus on the reporting period. Consequently, we believe that the declaration should be based on the reporting period and reference to the date of the annual report omitted.

> "A declaration of whether the board can reasonably conclude that the company's risk management and internal control systems have been effective throughout the reporting period ~~and up to the date of the annual report~~"

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 believe that reporting should be limited to controls over financial reporting, which we believe to be the preferred approach of the 2022 government white paper Restoring trust in audit and corporate governance. To include narrative reporting significantly increases the control functions that would be brought into scope. See also our response to question 13 above. Were the decision made to retain the proposed wording, we would ask that companies be given a longer lead time before the wider scope is part of the internal controls declaration. This would be a more proportionate approach.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

This would be helpful and, in our view, guidance should be issued at least twelve months in advance of the required implementation date.

We have come to this conclusion during our discussions with members as the absence of clear guidance actually makes some of the consultation questions more difficult to answer. In brief, there seems to be a gap between company perception of what is required to give the internal controls declaration and FRC perception of the scale of the task – and until there is more guidance that gap will remain.

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?

Guidance would be helpful on these points, but ultimate responsibility should, of course, rest with the board. In Provision 29, it does seem slightly odd that the definitions of emerging and principal risks are included as footnotes. We suggest that these might helpfully be included in the text of the Provision. We have also tried to remove duplication in the final two sentences and suggest the following:

> 29. "The board should carry out a robust assessment of the company's emerging and principal risks. **Emerging risks should include those whose impact and probability are difficult to assess and quantify at present, but there is a reasonable probability of affecting the company over a longer time horizon. Principal risks should include, but are not necessarily limited to, those that could result in events or circumstances that might threaten the company's business model, future performance, solvency or liquidity and reputation. In deciding which risks are principal risks companies should consider the potential impact and probability of the related events or circumstances, and the timescale over which they may occur.**
>
> The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated. **It** should **also** explain ~~in the annual report~~ what procedures are in place to identify and manage emerging risks and describe these risks."

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

No.

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

Yes, we agree that retaining the existing Provision 30 is helpful. This ensures the coherence of this reporting alongside the subsequent assessment of prospects in the following provision. Furthermore, it contributes to maintaining a consistent approach across the Code, encompassing all companies, not solely PIEs.

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

Yes.

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

Yes.

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

Generally, yes. However, we do have some observations on the text:

- The new wording of Principle P effectively mandates the inclusion of ESG performance metrics. This is something that should remain at the discretion of the Remuneration Committee which is best placed to determine the most effective metrics to ensure successful delivery of the company's long-term strategy.
- One of the amendments to Principle Q places an explicit responsibility on the remuneration committee for "authorising remuneration outcomes". Although some of our members welcomed this changed emphasis, we wonder whether it is deliberate as it is, in many companies, a matter for the board to accept or reject recommendations from the remuneration committee. We believe that this change should be reverted.
- We do not agree with the use of the word 'outcomes' in Principles P and Q, as it suggests a narrow focus limited to final individual payouts, rather than encapsulating the entirety of remuneration arrangements. We do not believe that this is the intention, in which case the word 'arrangements' is preferred.

Our suggestions are as follows:

> Principle O: "A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. No **individual** should be involved in deciding their own remuneration **arrangements**."
>
> Principle P: "Remuneration **arrangements** should be aligned to company performance, purpose, and values, and the successful delivery of the company's long-term strategy including**, [as appropriate / for example],** environmental, social and governance objectives."
>
> Principle Q: "The remuneration committee should exercise independent judgement and discretion **including** when **recommending or determining** remuneration outcomes, taking into account company and individual performance, workforce pay and conditions and wider circumstances**, as should the board when considering these recommendations**.

We like the addition to Provision 35 relating to the approach to investing in and rewarding the workforce, but our members warned that meaningful disclosure could be challenging for a multinational/multi-business company, where necessarily different approaches may be adopted for a multitude of different circumstances.

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

Not entirely. Whilst we understand why it is felt necessary to include wording around malus and clawback in the Code, we are not sure that the proposed changes will have the desired effect and it is not clear whether the provision covers all cases of malus and clawback or just those relating to executive directors – we assume the latter as otherwise this creates a significant extension of executive reporting requirements. We agree with the amendments to Provision 39, but have a number of comments about the new Provision 40:

- The first two bullet points of Provision 40 – "a description of its malus and clawback provisions, including:
    - the minimum circumstances in which malus and clawback provisions could be used
    - a description of the minimum period for malus and clawback and why the selected period is best suited to the organisation

  \- cover points that should be covered in the company's remuneration policy, approved by shareholders at least every third year. There seems no logic in including these points in the annual report in years in

which the remuneration policy is not being presented for shareholder review – the policy should be on the company's website. The word 'minimum' is odd and there would be circumstances in which 'maximum' might be more appropriate – for example, levels of pollution or sewage discharge in an environmental target. We assume that what is intended here is the point at which malus and clawback would be triggered.

- The final section of Provision 40 requires that "Companies should set out the use of their malus and clawback provisions in the last five years". We do not think that this is necessary as any use of malus and clawback should be reported in the remuneration report relating to the year in which it occurred.

We would therefore suggest amending Provision 40 as follows:

> 40. "The annual report on remuneration should include ~~a description of its malus and clawback provisions, including: • the minimum circumstances in which malus and clawback provisions could be used • a description of the minimum period for malus and clawback and why the selected period is best suited to the organisation; and •~~ whether the provisions **relating to malus and clawback** have been used in the last reporting period. If **these** provisions have been used, a clear explanation of the reason should be provided in the annual report. ~~Companies should set out the use of their malus and clawback provisions in the last five years21.~~ "

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

We agree with the proposed revisions to former provisions 40 and 41, now captured in Provision 43, although as noted below, some of our members thought that the second bullet of former provision 41 – "reasons why the remuneration is appropriate using internal and external measures, including pay ratios and pay gaps" should have been retained to emphasise the importance of pay gap and pay ratio analysis.

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

Our members' views differ on this question, although most acknowledge that there remains substantial room for improvement in this area.

Some take the view that they should be reinforced as they are valuable management tools, especially given their role in shedding light on compensation justifications, but more agree that they should be removed, on the basis that references to pay gaps and pay ratios lack meaningful impact. As these items are required under separate legislation, their presence in the Code seems unnecessary.

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

Not yet. The simple term 'artificial intelligence or AI' encompasses a variety of technologies and we believe that human oversight of, and accountability for, AI applications is very important, but it is rather too early to address this challenge in the Code.

But that will change over time. At this stage, the one area that the Code might usefully consider is consequently that of AI-related risks, along with a corresponding integration of AI considerations within risk statements.

However, that said, we do believe that the forthcoming guidance should include some overarching principles for AI, especially where there is reliance on data collated and assessed using generative AI technology and where the use of AI relates to corporate governance.

If you would like to discuss any of the above comments in further detail, please do feel free to contact me.

Yours sincerely,