M&S

EST. 1884
Waterside House,
35 North Wharf Road
London W2 1NW
Tel: 020 7935 4422
marksandspencer.com

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

By email to: codereview@frc.org.uk

UK Corporate Governance Code Consultation

Thank you for the opportunity to respond to the proposed changes to the UK Corporate Governance Code. We are broadly supportive of the proposals, although we believe several simply formalise work which is already being done by many in practice. Acknowledging the recent legislative and governance reforms proposed by the Government are a main driver for this consultation, we are also somewhat hesitant as to whether it is necessary for such changes to be incorporated into the Code when they will be governed by separate legislation, i.e., the Resilience Statement, the Audit and Assurance Policy, and reporting on climate ambitions and transition planning.

We expand on these thoughts within our responses to the consultation questions below. Please note we have only responded to questions where we would like to express our views.

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 are supportive of removing boilerplate statements from reporting and we agree, this does not add value and unnecessarily adds to the length of annual reports. However, we are doubtful that a "focus on outcomes" will produce better reporting. Governance practices and the application of the Code underpin all Board decision-making and strategy setting, and so we expect these changes will only lead to yet more boilerplate statements on how governance has produced a company's performance during the year. Given the impact of governance should be visible in a company's strategic performance reporting, we believe it would be more appropriate to focus on disclosing the nature of activities/discussions during the year, to demonstrate how directors have had due regard and considered the long-term sustainable success/strategy of the company.

We do not believe it is necessary to include reference within the Code itself that a clear explanation should be provided where there are departures from provisions. This is the nature of the Code and referencing this unnecessarily increases its length without adding value.

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 question the need to specifically call out climate ambitions and transition planning in Provision 1. We would argue this is already be covered by "how environmental … matters are taken into account in the delivery of its strategy". The importance of climate, and therefore the need to report, varies between different

sectors. Additionally, climate reporting is already required in reporting against the Task Force on Climate-Related Financial Disclosures (TCFD).

Environmental and social matters are already embedded within our strategy and management activity. This is aligned to a recent review we conducted of our investors and brokers, who told us they wish to understand how our ESG strategy and performance is aligned with the core company strategy and driving business value. With the introduction of TCFD and further regulations on the horizon, the inclusion of climate reporting in the Code only adds unnecessary duplication within company reporting.

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

We are not supportive of the proposed amends to Provision 2; without further guidance, it is unclear how the board can be expected to measure, and therefore report, on how effectively its desired culture has been embedded. Additionally, we do not believe reporting on this will tangibly benefit or provide meaningful information for shareholders/investors. The current wording of the provision is sufficient, and we do not believe any amends are necessary, particularly as the Provision already states "the annual report should explain the board's activities and any action taken" in its assessment and monitoring of culture.

We also believe the proposed changes to Provision 3 are unnecessary. Reporting on shareholder (and stakeholder) engagement is already extensive and is not an area we believe requires additional focus. If there is to be increased focus, we believe this should be aimed towards smaller, private shareholders.

SECTION 2 – DIVISION OF RESPONSIBILITIES

We have responded to Q4 and Q5 collectively.

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?

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?

The level of detail expected to be disclosed as part of the annual performance review is unclear. We already report on directors' external appointments, and explain how time commitments are reviewed annually as part of our board review each year. We are unclear how the proposed changes to Principle K and Provision 15 will therefore change existing practice. If the intention is to include an individual review for each director, we believe this will unnecessarily increase the length of reports with no direct benefit to shareholders (and other stakeholders). We think meeting attendance, along with details of external directorships and the Board's annual performance review, should be sufficient disclosure to investors of whether the directors have sufficient time to adequately discharge their responsibilities. Including commentary on each individual director is also likely to become a boilerplate, 'tick box' exercise, of simply listing appointments.

We are not opposed to listing additional 'significant' external commitments of directors; however it is difficult to know how extensive lists of directorships will become without further guidance on the definition of a 'significant appointment'. We welcome further guidance on this in due course.

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 believe the current version of the Code suitably promotes companies to consider diversity within board composition, succession and evaluation. We do not think the proposals will help to move reporting on in this area any further. Targets that sit outside of the Code, including from FTSE Women Leaders and the Parker

Review, are likely to be more effective in driving diversity forward. Expanding the remit of the Code in this area is, again, unnecessarily duplicative.

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 support the addition to Provision I that appointments should "promote equal opportunity" and think this is an important addition. However, we are not certain it is necessary to change the remaining wording on Provision I to capture wider characteristics of diversity. We are not opposed to the inclusion of all protected and non-protected characteristics, and of course these should be a consideration for boards, however, we do not see the value in adding this specifically into the Code. It could lead to more complicated reporting whereby each protected and non-protected characteristic of each director is listed, which wouldn't be additive. Furthermore, while HR professionals will be familiar with the definition of "all protected and non-protected characteristics", it could add some level of confusion to those who are not familiar with the correct definition, and it could be more beneficial to have a more prescriptive list. This would add more clarity surrounding the topic.

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

Appointments and succession planning to the board and senior management are already reported on. The increased focus on diversity has already meant reporting tends to include narrative on how diversity was considered during the appointment process. Adding this into Provision 24 is likely formalising existing practice which we are supportive of.

Following the introduction of Listing Rule 9.8.6R(10), we do not believe it is necessary to retain within the Code reporting on: "the gender balance of those in the senior management and their direct reports". We suggest this is removed as reporting on this is now governed by the Listing Rules.

<u>SECTION 4 – AUDIT, RISK AND INTERNAL CONTROLS</u>

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

Preparing the AAP on a comply or explain basis would be useful and would help companies to shape and steer their approach to a number of regulatory changes and wave of non-financial reporting disclosure requirements as they see fit. However, 'comply or explain' isn't always helpful from an audit perspective. Without clarity for auditors or companies on how to adequately audit/assure the growing plethora of non-financial/sustainability information, will this drive the right behaviours? If there is a lack of what 'explaining' looks like, the audit profession will likely drive lengthy disclosures that are not always helpful to readers of the Annual Report and Accounts. This then has the potential to divert management time and resources to disclosures, with less focus on strategic objectives and value add activities.

Additionally, we question how useful the inclusion of the AAP as part of the Code is, as it will be governed by separate legislation (the draft Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023). Including in the Code is duplicative and may increase reporting burden for companies not already captured by the regulations.

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?

Audit tender policies and the promotion of effective competition, as well as the non-audit services policies, will likely form part of the AAP. Is it therefore necessary to call this out separately within Provision 26 (previously 25)?

In terms of the proposed amends to Provision 27 (previously 26), we question the inclusion of: *"where commissioned by the board, the assurance of environmental, social and governance metrics and other sustainability metrics"*. Should this be a matter for the audit committee? Trajectory in recent years has been towards establishment of an ESG Committee, and so what is the role of an ESG committee if this is being handed back to audit? Given some of the focus of this consultation appears to be the embedding of ESG matters in the Code, it does seem to be a missed opportunity to not formalise the role of an ESG Committee. Particularly as the audit committee's roles and responsibilities are already very extensive. We would question whether audit committees have the capacity and correct experience to take on accountability for the assurance on ESG metrics. We expand on this below in our response to Q12.

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?

The audit committee's roles and responsibilities are already very extensive. We question whether they have capacity to also take on accountability for the assurance on narrative, sustainability and ESG reporting. We do not believe they do and suspect giving them additional responsibilities risks providing an illusion of governance over these matters, when realistically the committee may not have sufficient time to dedicate and give them the required scrutiny. This also brings into question how audit committee members' time commitments will be measured and how this will feed back into overboarding – we would need further clarification in any associated guidance. Additionally, members of the audit committee tend to have extensive financial experience and we question whether they have the appropriate skills to assure narrative/sustainability reporting as well; these changes may require boards to review the composition of their audit committees.

Ultimately, given the widespread responsibilities this would give audit committees, does this not undermine the role of boards as a whole? We suggest that, rather than interspersing ESG throughout the Code, would it not be more useful to have a new Sustainability section, which speaks to the roles and responsibilities of an ESG Committee?

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 that the proposed amendments provide a more balanced approach between setting a proportionate responsibility for the Board, with a level of tailoring – although, as set out in relation to Questions 16, 17 and 18, further guidance will be needed in a number of key areas – such as defining materiality, and guidance on what in the eyes of the FRC constitutes an effective system of internal control.

We would however request further clarification on the definition of materiality in the context of non-financial reporting and its interaction with the concept of materiality used in other contexts – for example financial statement materiality or the forthcoming requirement to consider controls over material fraud. While we can more readily quantify financial significance, what would count as "significant" for narrative reporting or material in relation to operational activities? How is a user of the financial statements able to understand the different consequences of quantitative versus qualitative assessment of materiality to comply with different regulations or legislation within the same report?

The guidance referred to in the consultation paper in relation to 'circumstances in which external assurance might be considered appropriate' will be particularly welcome. Obtaining clarity on what this will recommend, allowing business to both plan for the scope and approach, resource needs (including potential external support) and the potential costs will be key. Until available, the proportionality of the proposed approach is hard to gauge.

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 do not think this should be based on the date of the balance sheet. If controls are only relevant at the balance sheet date, this doesn't provide meaningful assurance that there weren't potential material weaknesses at other points in the year.

However, care needs to be taken in referring to 'continuous monitoring' – this suggests an ongoing assessment which in reality is unlikely to be appropriate nor practical to comply with and is different to periodic assessments (e.g., quarterly or biannually) that will most likely be used by the board to monitor operating effectiveness.

We therefore believe the assessment should be made over the whole reporting period up to the date of the balance sheet recognising that certain controls are only operated and/or monitored at key points in time during the year.

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?

To be able to answer this question we require further clarification/guidance on the definition of reporting. Does this include external reporting, regulatory reporting, management reporting, etc.?

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?

While recognising the intended approach is to not be overly prescriptive, the absence of any reference to the 'standard' expected to be achieved even as guidance could create inconsistency. As a minimum, the guidance should set out details of the standard envisaged, even if not mandated, by referencing established systems of internal control – most likely COSO.

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?

As set out on Q16, to avoid ambiguity an established system of risk management and internal control will need to be incorporated in the guidance to allow boards to measure themselves against.

Detailed guidance will need to be provided on the definition of materiality under the proposed code changes. We are in danger of simplistically applying the concept in a number of different ways within the same stakeholder communication. For example, financial statement 'materiality' can largely (although not wholly) be linked to quantitative values, as currently set out in the audit opinion. Material fraud is however likely to require a different definition – the qualitative assessment potentially being much more nuanced than in the context of financial reporting and with a much lower quantitative value. Emerging reporting, linked for example to environmental matters, could have a further different assessment recognising the longer timeline involved in initiatives in this area. Similarly, defining what represents a 'material' operational issue is a further complexity. Guidance on materiality will therefore need to cover the different elements now being incorporated in future responsibilities to what has typically been applied in a financial context.

As well as for boards, the guidance will need to address how a user of the financial statements is able to understand the different consequences of quantitative versus qualitative assessment of materiality on different reporting areas and to comply with different regulations or legislation within the same report.

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

While already envisaged, the guidance referred to in the consultation paper in relation to 'circumstances in which external assurance might be considered appropriate' will be particularly welcome. Obtaining clarity on what this will recommend, allowing business to both plan for the scope and approach, resource needs (including potential external support) and the potential costs will be key. Until available, the proportionality of the proposed approach is hard to gauge.

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 have included our response to Q19 within our response to Q20 below.

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

We agree that all Code companies should continue to state whether they are adopting a going concern basis of accounting and companies should report on their future prospects, although these will both likely be incorporated within the Resilience Statement. However, we welcome guidance to be issued for the proposed period to be covered by the Resilience Statement. Being prescriptive on the periods for the resilience statements would not suit all industries. For example, within retail it is very difficult to forecast future prospects meaningfully over any period longer than three to five years.

We note that the proposals adopt AAP into the Code, potentially making non-PIEs needing to maintain an AAP, but the same is not true here with the Resilience Statement. This feels inconsistent.

SECTION 5 – REMUNERATION

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

We request further clarity on the expectation under the proposed changes to Principle P (previously Q). While the importance of ESG metrics within our company strategy is clear, and indeed interwoven across all aspects of our business, we would be concerned if the inclusion of ESG metrics within remuneration were to become 'compulsory'. Our apprehension is that this becomes a 'box ticking' exercise rather than motivating behaviour that truly drives both the sustainable agenda that, in the case of M&S, is already embedded within management activity and the delivery of shareholder value. Furthermore, we would question if in certain circumstances the inclusion of an ESG metric may be elevating pay unnecessarily as it effectively 'double counts' an achievement due to happen anyway. Linking the remuneration policy and outcomes to corporate performance is key, however, we do not think that proposed revisions strengthen such links.

In regard to the taking into account workforce pay and conditions when authorising remuneration outcomes (Principle Q, previously Principle R), this is already a key consideration and activity of the M&S Remuneration Committee and, given the fundamental importance we place on such considerations, we welcome the amend to the principle.

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

Reflecting best practice, we already apply malus and clawback to all executive director incentive arrangements and these are already described as such within our Directors' Remuneration Report (DRR). We do not feel the proposed reporting changes are necessary, or how it adds value/benefit for investors.

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

Provision 40 – we see this as a like-for-like update, albeit streamlined.
Provision 41 – we welcome the removal of these disclosure requirements which should lead to slight streamlining of the DRR. Noted is the update to include the alignment of remuneration with ESG objectives, also reflected in the updated Principle P (previously Q). Our comments on this are included in our response to Q22.

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

We do not believe the inclusion of references to pay gaps is necessary. Pay gaps and ratios are covered in other legislation and it would only be duplicative to include within the Code as well.

Other general comments on the consultation

The purpose of the Code is to provide a set of high-level best practice guidelines for premium listed companies. While there is some flexibility in that the Code remains 'comply or explain', the increasingly strong expectation of investors, the proxy voting agencies and auditors, is that we should be complying with the Code (and of course we strive to do as best practice). Any deviation from the Code, regardless of how this is explained, is more often than not challenged by auditors and viewed critically by proxy voting agencies, which can negatively impact Annual General Meeting voting recommendations. The changes being proposed by this consultation will therefore ultimately be viewed as additional requirements to be met, and it is for this reason that we are concerned these proposed amends move the Code away from being primarily principles-based, making it more prescriptive.

As will have been obvious from our responses, we also view the proposed amends in this consultation to be duplicative. The changes, such as including reporting on climate ambitions and transition planning, and preparation of an AAP, are primarily driven by equivalent changes to regulation/legislation. Given there will be regulatory/legislative requirements that will govern reporting in these areas, it seems unnecessary and onerous to repeat these in the Code.

This duplication is also particularly unhelpful given how corporate reporting has increased drastically in recent years. M&S' annual report has more than doubled in length over the last decade and we believe it is imperative that reporting does not continue on this trajectory; annual reports are already increasingly unmanageable for stakeholders to navigate and find the information they are interested in. The proposed changes to the Code will only increase the length of annual reports further, as companies attempt to report against these prescriptive requirements. This appears to be in direct contradiction to the aims of the Government's consultation on Non-Financial Reporting, which looked to reduce the reporting burden on companies.