



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

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Dear Ms Merrick

The Wates corporate governance Principles for large private companies

PricewaterhouseCoopers LLP welcomes the opportunity to respond to the consultation on the proposed corporate governance Principles for large private companies.

We broadly support the proposals, which we think cover most of the right areas and issues and are pitched at a reasonable level compared with the full UK Corporate Governance Code. We summarise our main observations on the proposals below. These are also reflected in the Appendix to this letter, which includes our responses to the specific consultation questions.

Purpose of the proposed Principles and the need for additional guidance

No-one should expect the use of the Principles (including the 'Guidance for consideration' that accompanies them) to eliminate the risk that a private business, like any other, will fail. As James Wates states in his Foreword to the consultation document, they will not "cure all the ills in the business world". Nevertheless, we agree that large private companies are of such significance to a range of stakeholders that it is desirable for them to have high quality corporate governance arrangements in place, tailored for their specific circumstances. We also agree that they can reasonably be expected to report in a transparent way on those arrangements, as some 'very large' private companies will be required to do from 2019 under the Companies (Miscellaneous Reporting) Regulations 2018 ("the reporting Regulations").

In our experience, many large private businesses take governance very seriously and already have an appropriate framework in place. It should therefore be made clear that the primary purpose and focus of the Wates Principles is to encourage those who could benefit from applying the good practice that others already follow. This is one of the reasons we agree that the Principles should be high-level: being too prescriptive is likely to discourage those who are applying formal governance arrangements for the first time. On the other hand, companies new to formal governance frameworks are likely to need additional practical guidance and examples of how to implement such high-level Principles, so we think it's vital for this to be provided if the overall framework is to be effective. PwC and other firms will of course work with their clients as they implement the Principles, but we urge the FRC and/or other members of the Coalition group to consider issuing supplementary guidance in due course to help those companies and boards that are likely to face the biggest challenges. We would of course also be happy to assist with that process.

We think it is particularly important for subsidiary companies to have additional help targeted at them. In our view it is likely that many subsidiaries will in fact choose not to apply the Wates Principles (or any other governance code) in full, as the reporting Regulations allow; they may instead

*PricewaterhouseCoopers LLP, 1 Embankment Place, London, WC2N 6RH
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7212 7500, www.pwc.co.uk*



focus on the aspects of governance that are relevant in their circumstances, reflecting the roles and responsibilities that are and are not fully devolved by their parent company. Guidance to ensure that this is done appropriately will therefore be particularly important.

The relationship between the proposed Principles and the Companies Act reporting Regulations

We support the encouragement in the consultation document for the proposed Principles to be used by companies that are not subject to the new reporting Regulations, which means that the Principles cannot be drafted so as to assume that a company applying them will also be reporting under the Regulations.

Many of those applying the Principles will, however, also be caught by at least some parts of the Regulations and we believe that the relationship between the two should be dealt with more systematically than is currently done in paragraph 9 onwards of the Introduction to the consultation document, distinguishing between the governance, stakeholder engagement and Section 172 elements. Specific points that should be addressed are:

- The Principles refer to reporting being on an ‘apply and explain’ basis. The reporting Regulations require companies to report on how they have applied their chosen code, which is consistent with this, but also require explanations for departures from it (that is, ‘comply or explain’ reporting).
- In some respects (for example employee engagement) the reporting Regulations are more prescriptive about what needs to be considered and they, in effect, make some of what is included in the Principles or Guidance for consideration mandatory.

We recommend explaining the significance of these differences within the overall document including the Principles, even if not in the Principles themselves, in a way similar to that used for the requirements of the Disclosure Rules and Transparency Rules within the UK Corporate Governance Code document.

It is particularly important to explain the status of the ‘Guidance for consideration’ in the context of the ‘comply or explain’ reporting requirement under the reporting Regulations: we presume that the intention is not that each and every aspect of the Guidance would need to be explained if not complied with (and indeed some of it is not appropriate for comply or explain).

Reporting on the Principles

Following on from the last point, although the relationship between the proposed Principles and the reporting Regulations is not discussed in detail, there is an implicit assumption that there will be some reporting against the Principles by any company that chooses to use them, regardless of whether the Regulations also apply to them. In particular, there is a section in the Introduction to the consultation document that sets out the ‘apply and explain’ reporting concept, though it is not clear whether this will be part of the final document. Presumably it will be and, if it is, it should be clearly recognised that to implement ‘apply and explain’ will demand a significant piece of reporting that is wholly new for many companies. Specific technical guidance on this should be provided, including for instance where in an annual report (or elsewhere) the relevant information is expected to be given.



There is also a particular issue in relation to how groups headed by private companies will report on their governance arrangements where only one or more subsidiaries are caught by the thresholds in the reporting Regulations. Because the governance reporting aspects of the Regulations are to be applied on an entity by entity basis (subject to an open question with BEIS), we believe this will result in relatively meaningless and incomplete information in many group situations where other subsidiaries (and often the parent) are not caught. We therefore suggest that the Principles address this anomaly by recommending governance reporting that reflects all the material elements of a group.

Remuneration

As some of the issues underlying the debate about executive pay in the listed company space are also applicable to private companies we agree that remuneration should be addressed in the Principles. The Guidance for consideration under Principle Five refers at a high level to the need for principles to underpin director and senior management pay, and for pay to be ‘appropriate and fair’. It may be that the concepts in Provision 40 of the UK Corporate Governance Code could also be referred to in the Guidance, including the clarity, simplicity and predictability of schemes, the impact of pay and incentives on risk, and proportionality between pay and performance.

In our view, however, it will be challenging for private companies to talk meaningfully about pay without the numerical disclosures that quoted companies are required to make: the discussion of remuneration governance arrangements alone has the potential to descend quickly into boilerplate. It could feel as though the most important evidence that would allow the reader to make informed judgements about matters such as the appropriateness of the quantum of pay and the relationship between pay and performance is missing from the remuneration disclosure. We do not expect, or necessarily recommend, that many private companies will provide detailed numerical disclosures on a voluntary basis (though we recognise that some are being encouraged to do so by regulators and industry groups). In the absence of this information, to reduce the risk of boilerplate, it would be helpful for the Guidance to include more specific suggestions for matters that it may be appropriate to report on.

We strongly believe that the main priority of Principle Five should be the overall relationship between a company and its owner and directors, and how this is conducted in a way that is consistent with the purpose, strategy and culture of the organisation. In standalone private groups this could mean discussing the relationship between pay, reinvestment of profits by owners and dividends, for example. For subsidiaries, it may be a matter of explaining how directors are remunerated, the extent to which this is or is not locally controlled, and why.

Post-implementation monitoring and review, including the role of auditors

The success of the new reporting Regulations is likely to be monitored by the Government, as it will want to assess the effectiveness of the measures it has introduced. Subject to the outcome of the Kingman review, the FRC is likely to play a role in this, and could expand the scope of its annual *Developments in corporate governance and stewardship* publication to cover private companies. Another option for monitoring would be a model such as the Davies / Hampton-Alexander annual reports on gender diversity, which were supported by Cranfield University: this model tends to result in more ‘opinionated’ monitoring than the FRC generally produces (including naming and shaming). It may be that one or more members of the Coalition group would be interested in taking this forward. We also expect that some stakeholder groups will analyse companies’ reporting and procedures in



particular areas of interest (such as workforce engagement or environmental impact). In the first instance, however, we believe that it is important for companies to be allowed and encouraged to develop good practice through open dialogue and positive reinforcement.

The success of the Wates Principles as a driver of enhanced governance processes and procedures *within* companies will be harder to measure – experience shows that there is some, but not full, correlation between good governance reporting and good governance in practice. Auditors will have a role in checking that what is reported about governance is not inconsistent with their knowledge acquired in the course of the audit, but users of the new governance reporting should not be misled as to the extent of auditor involvement in ‘checking’ governance arrangements. Much will depend on those within and closely connected with companies to spot issues and react in good time, whether they are directors, shareholders or other stakeholders.

If you have any questions regarding the views in this letter, please contact Suzi Woolfson on 07711 733985. We would be happy to discuss any of the issues raised and make further drafting suggestions if this would be helpful.

Yours sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive style and includes a long, sweeping underline that extends to the right.

PricewaterhouseCoopers LLP



Appendix – Responses to consultation questions

Question 1 – Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

As noted in our covering letter we believe that the Principles address most of the key areas and issues appropriately.

Specific matters that we believe should be added to the Principles and Guidance for consideration are:

- In the 4th paragraph of the Guidance on Principle Two, individual evaluation of directors is mentioned, but there does not appear to be any recommendation of an overall board evaluation.
- On a related point, we would expect some encouragement of succession planning within Principle Two.

Question 2 – Are there any areas in which the Principles need to be more specific?

As noted in our covering letter, we strongly recommend that further, more specific guidance is developed to help those private companies and boards that are likely to find implementing and reporting on a formal governance framework most challenging. There are few precedents available to such companies, unlike in the listed company marketplace, and we do not think it will be effective simply to sit back and wait for good practice to develop.

Question 3 – Do the Principles and Guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

As noted in our covering letter, we believe that subsidiary companies in particular will need further help to implement and report on governance formally. We recognise that it will be difficult to merge this with the style of the Principles and existing Guidance, so would address it either in the additional guidance we are recommending, or in a separate section of the document which includes the Principles.

Question 4 – Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors' remuneration?

As noted in our covering letter, we think that this will be challenging for companies so we recommend being as clear as possible about what is expected. We see it as particularly important for the Principles to address the overall relationship between a company and its owner/directors, not to focus on pay exclusively.

Question 5 – Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?



No – we believe that the mention in the 3rd paragraph of the Guidance on Principle Six is adequate.

Most companies that apply the Principles will also be subject to the new stakeholder engagement and Section 172 reporting under the Companies (Miscellaneous Reporting) Regulations 2018. This is an instance of where the relationship between the (voluntary) Principles and the (mandatory for those caught by the thresholds) Companies Act reporting Regulations should be more systematically recognised (as we recommend in our covering letter).

Question 6 – Do the Principles enable sufficient visibility of a board’s approach to stakeholder engagement?

See our response to Question 5 above.

Question 7 – Do you agree with an ‘apply and explain’ approach to reporting against the Principles? If not, what is a more suitable method of reporting?

We agree with ‘apply and explain’ as a concept as it means that companies and boards must describe their governance arrangements rather than just confirm that they exist. The additional time, effort and expense that this significant piece of reporting will entail for some companies should not be underestimated, however.

Again, many companies that apply the Principles will also be subject to the part of the Companies (Miscellaneous Reporting) Regulations that deals with governance reporting and this is another instance of where the relationship between the Wates Principles and the Companies Act reporting Regulations should be more systematically recognised (as we recommend in our covering letter).

Question 8 – The Principles and the Guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and Guidance would encourage good practice?

As we note in our covering letter, there are various options for monitoring and encouraging good practice in governance reporting by large private companies. Where companies fail to put in place arrangements commensurate with their significance and risk profile, it is important that directors, shareholders and other stakeholders hold them to account. Auditors will also draw attention to any instances where governance reporting is not consistent with their knowledge acquired in the course of auditing the financial statements.

Question 9 – Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?

Broadly yes, as we explain in our covering letter.

Question 10 – We welcome any commentary on relevant issues not raised in the questions above.

Reporting

As we note in our covering letter, we think that the expectations around reporting need to be made much clearer: there is currently an underlying assumption that companies will be reporting under the



Companies (Miscellaneous Reporting) Regulations 2018 but, given the high thresholds for the governance aspects of the reporting Regulations in particular, this will not always be the case.

On a specific point about reporting, the 2nd paragraph of the Guidance on Principle Six recommends that the board presents a fair, balanced and understandable assessment of the company's position and prospects and makes this available to material stakeholders on an annual basis. Without more information about reporting expectations in general, it's not clear whether this means that such an assessment might be provided:

- Outside the annual report (although most companies will address it in relation to the content of their strategic report); and/or
- Only privately (for example to the owners/directors and workforce).

Use of language

Principles One, Two and Six are written largely in the present tense, and describe desired qualities or outcomes; the other Principles and the Guidance for consideration generally use instructive language based around "should", with a smaller number of uses of "must" and "could". We recommend that the style of the Principles is harmonised.

We do not feel that the language of the Guidance needs to change but we would include a note in the introductory section of the document reminding users that "should" and "must" are to be read in the light of paragraph 17 (assuming this is included in the final document) and do not imply a checklist of matters that must be addressed.

Principle Three and constitutional documents

Principle Three notes the importance of a company's constitutional documents, and we agree with this strongly – this may be of particular significance to smaller companies and subsidiaries, where governance arrangements are often not formal.

It should also be recognised in that Principle that there may be occasions where the Articles restrict the board's ability to amend the governance structures in place, including arrangements for 'independent challenge'. Where possible, companies should therefore be encouraged to have constitutional documents that allow them to flex their governance arrangements as the business develops.