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Submitted by email to: remcon@frc.org.uk

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Dear Catherine

ICSA response to consultation on Directors' Remuneration: possible amendments to the UK Corporate Governance Code

We welcome the opportunity to comment on possible amendments to the UK Corporate Governance Code (the Code) in the light of amendments to the regulations on reporting directors' remuneration. As you will be aware, the Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries and, as such, our members are well placed to understand the desirability, or otherwise, of the possible amendments to the Code

In preparing our response we have consulted, amongst others, with members of the ICSA Company Secretaries Forum, which includes company secretaries from more than 30 large listed companies from the FTSE100 and FTSE250. However, the views expressed in this response are not necessarily those of any individual members of the ICSA Company Secretaries Forum nor of the companies they represent.

We have made some general points under each of the issues where views are sought, together with our response to the specific questions set out in the consultation.

1. Extended clawback provisions

With regard to clawback provisions and, in particular the comments under paragraph 7 of the consultation, we would make the general comment that the financial crisis was brought about by the failure of some banks and was not a general failure of governance across all sectors. We therefore see no reason why the requirement to have a clawback mechanism in place should be extended to sectors outside financial services.

We are aware that there have been – and probably will be in response to this consultation – some suggestions that guidance would be helpful in this area, given that a significant

proportion of the FTSE100 have already introduced such measures. However, guidance of this kind reflects rapidly changing market practices and we do not believe that it would be appropriate for it to be included in the Code. Whilst we agree that it would be very helpful, we would see this as something for Government to initiate separately.

1.1 Is the current Code requirement sufficient, or should the Code include a "comply or explain" presumption that companies have provisions to recover and/or withhold variable pay?

As indicated in our general comments above, we do not think that the requirement for service contracts to include clawback provisions should be extended to sectors outside financial services. We therefore consider that the current clause in Schedule A that "Consideration should be given to the use of provisions that permit the company to reclaim variable components..." is sufficient and the Code does not need to be amended to include a "comply or explain" presumption. A clawback provision in service contracts is now commonplace and is considered standard practice; however, some existing service contacts may not include such a provision. We therefore think it is preferable for the Code to retain the existing wording and leave it to companies to explain their current practice in relation to clawback, as appropriate.

1.2 Should the Code adopt the terminology used in the Regulations and refer to "recovery of sums paid" and "withholding of sums to be paid"?

If there were to be any changes made to the Code, we would support this proposal. It would probably be helpful for the terminology to be consistent with the Regulations, but we do not think it is essential.

1.3 Should the Code specify the circumstances under which payments could be recovered and/or withheld? If so, what should these be?

We do not think it would be practical or helpful for the Code to specify when clawback should apply. Circumstances vary hugely from company to company and, in particular, between sectors.

1.4 Are there practical and/or legal considerations that would restrict the ability of companies to apply clawback arrangements in some circumstances?

We think it is likely there would be legal issues restricting the ability to apply clawback arrangements, including the fact that some older service contracts do not include such a provision. There are also practical problems that restrict the ability of companies to apply clawback and one major issue is the difficulty in recovery when an employee has left the company.

2. Remuneration committee membership

We would highlight the comments in paragraph 10, regarding remuneration committee membership and, in particular, the comment that where remuneration committee members are executives in another FTSE350 company "there is a perceived conflict as these individuals have a personal interest in maintaining the status quo in pay ...". The tables of statistics provided under paragraphs 12 and 13 clearly show that this perception is not the reality and we do not believe there is any other evidence to support this view.

2.1 Are changes to the Code required to deter the appointment of executive directors to the remuneration committees of other listed companies?

No. We are concerned that it has been thought appropriate to deter the appointment of executive directors to remuneration committees as non-executive directors (NEDs) of other companies. It is our members' experience that remuneration committee members who are executives from other companies have a better understanding of remuneration issues, with current, relevant operational experience and a better understanding of the market, and that these NEDs tend to put 'downward pressure' on levels of remuneration rather than having the effect that has been assumed. As mentioned above, the FRC statistics disprove the assertion that remuneration committee membership is an inflationary issue. Our members' experience is that any 'upward pressure' or pressure to 'maintain the status quo' is more likely to come from a company's HR function or remuneration consultants.

We would also be very concerned if the code were to introduce a concept of 'limited independence' for individual NEDs. We think it is important to retain the board's assessment of NEDs as either independent or not independent. By regarding certain NEDs as being independent for some purposes, but having limited independence in relation to other matters, the Code would set a dangerous precedent.

Finally, we believe that such deterrence would be unhelpful in reducing the pool of potential NED talent. Many companies encourage the executives to take an NED role at another company as it is seen as giving benefits to both companies concerned as well as to the individual's own personal development. Any restriction on such individuals being able to be members of the remuneration committee would not only lose their technical expertise but also tend to restrict their opportunity to be an NED, especially in SMEs with their typically smaller boards.

3. Votes against the remuneration report

3.1 Is an explicit requirement in the Code to report to the market in circumstances where a company fails to obtain at least a substantial majority in support of a resolution on remuneration needed in addition to what is already set out in the Regulations, the guidance and the Code?

We do not think there is any need for the Code to include an explicit requirement for companies to explain a failure to receive a substantial vote in favour of its remuneration resolution. Please see our explanation of the practical difficulties below.

If yes, should the Code:

- **set criteria for determining what constitutes a 'significant percentage';**
- **specify a time period within which companies should report on discussions with shareholders; and/or**
- **specify the means by which companies should report to the market and, if so, by what method?**

Are there any practical difficulties for companies in identifying and/or engaging with shareholders that voted against the remuneration resolution/s?

The reasons why a company may fail to receive a substantial majority vote in favour of its remuneration resolution are varied and there is frequently no cohesive pattern of

reasons. In some instances different shareholders have different concerns and preferences, which can sometimes be in conflict. If a major shareholder is not willing to engage with the company in connection with its voting intentions, the company may never know the exact concerns of the shareholder.

If the Code were to be amended to include a specific requirement for a report to the market, we think there would be significant difficulties in attempting to set criteria for a 'significant percentage' as the shareholding profile of companies varies significantly. In some instances, a vote against by one large shareholder could result in a 'significant percentage', and a large shareholder may be an overseas investor setting different criteria for their voting.

We would also have concerns about the possibility of setting a time period for a report to the market. Where the issues are known to the company and understood, it is not uncommon for companies to make a statement explaining the vote against within a very short timeframe; sometimes with their AGM results announcement that is released immediately after the AGM. However, if the shareholders have not engaged with the company in advance of voting, it can take some considerable time to engage and understand their concerns. Sometimes shareholders are not forthcoming and it is therefore not possible for companies to know the reasons for votes against. Even if shareholder concerns can be ascertained and actions proposed, it will be necessary for a meeting of the remuneration committee to consider and approve them. Such meetings can happen infrequently and, in the event of a need arising at an AGM, it may be some time before the members can be assembled, especially if a large number of the members are based overseas. Setting a time period for an announcement would therefore not be practical as the time needed to be able to provide a report to the market would vary considerably, depending on the individual circumstances.

We think it should be left to companies to report to the market if and when they are able, and by whatever method they consider appropriate. It is common practice for companies to investigate internally the reasons for a substantial vote against a remuneration resolution and discuss the reasons with the remuneration committee. In our view this is an entirely appropriate response to this situation, whether or not it is accompanied by a report to the market.

Whilst we do not believe that any amendment to the Code is necessary or desirable in this case, if any requirement to report to the market is being considered, we think that the content should be restricted to the reasons given by those shareholders that provided written explanations for their vote to the company prior to the AGM in accordance with the Stewardship Code guidance on Principle 6. This would reduce the burden on the company and, at the same time, go some way to 'reward' compliance with the Stewardship Code.

4. Other possible changes

4.1 Is the Code compatible with the Regulations? Are there any overlapping provisions in the Code that are now redundant and could be removed?

We note that there are some provisions that appear in both the Regulations and the Code, however we think these provisions should remain in both. The Regulations are applicable to UK companies but the Code is applicable to all companies listed in the UK, whether or not they are UK registered. Overseas companies with a UK listing will be subject to local laws and regulations but will need to comply with the provisions of

the Code or explain their reasons for non-compliance. We think this is helpful in encouraging overseas registered companies to comply with the Code but also providing the flexibility for such companies to explain their non-compliance when the Code conflicts with their local laws and regulations.

4.2 Should the Code continue to address these three broad areas? If so, do any of them need to be revised in the light of developments in market practice?

We have considered all three board areas for possible amendment of the Code and, on balance, we are of the view that no amendments are necessary.

We hope the above comments are helpful and if you would like to discuss any of our comments in further detail, please contact me.

Yours sincerely

Peter Swabey
Policy and Research Director
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