

July 2018

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# Feedback Statement

## Consulting on a revised UK Corporate Governance Code

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Code changes since the December 2017 consultation

## EXECUTIVE SUMMARY

Having considered the responses to the consultation we believe that the new 2018 Code strikes a balance; setting a higher bar while acknowledging that all companies are different, and that one size does not fit all. Our aim is to improve corporate governance practice, stimulate constructive challenge in the board room and improve governance reporting. Set out below is a summary of the changes contained within the new Code.

The new Code broadens the definition of governance and emphasises the importance of:

- Positive relationships between companies, shareholders and stakeholders.
- A clear purpose and strategy aligned with healthy corporate culture.
- High-quality board composition and a focus on diversity.
- Remuneration which is proportionate and supports long-term success.

It is designed to set higher standards of corporate governance to promote transparency and integrity in business and attract investment in the UK for the long-term, benefitting the economy and wider society.

### Code content

Relationships with stakeholders are central to the new Code this is demonstrated as follows:

- Emphasis on improving the quality of the board and company's relationships with a wider range of stakeholders.
- Taking effective action when receiving significant shareholder votes against resolutions and reporting back more promptly.
- Board responsibility for workforce policies and practices which reinforce a healthy culture.
- Engaging with the workforce through one, or a combination, of a director appointed from the workforce, a formal workforce advisory panel and a designated non-executive director, or other arrangements which meet the circumstances of the company and the workforce.
- The ability for directors and the workforce to be able to raise concerns and for effective enquiry of these concerns.

Boards should be balanced, and regularly refreshed. The new Code:

- Emphasises the importance of independence and constructive challenge in boardrooms.
- Strengthens the consideration of 'overboarding'.
- Focuses on diversity, length of service of the board as a whole & its effective refreshment.
- Includes a Provision for a maximum nine year length of service for the chair, allowing flexibility to extend "to facilitate effective succession planning and the development of a diverse board... particularly in those cases where the chair was an existing non-executive director on appointment".
- Makes nomination committee responsibility for more effective succession planning that develops a more diverse pipeline. Reporting on the gender balance of senior management and their direct reports.
- Promotes higher quality external board evaluations, emphasising the importance of the evaluator's direct contact with the board and individual directors.

Executive remuneration should be linked to long-term success and the new Code supports this in the following ways:

- More demanding criteria for remuneration policies and practices.
- Clearer reporting on remuneration, how it delivers company strategy, long-term success and its alignment with workforce remuneration.
- Directors exercising independent judgement and discretion on remuneration outcomes, taking account of wider circumstances.
- Remuneration committee chair should have served on a remuneration committee for at least 12 months.

## Code structure and reporting

The Code does not set out a rigid set of rules; instead it offers flexibility through the application of Principles and through 'comply or explain' Provisions and supporting guidance. It is the responsibility of boards to use this flexibility wisely and of investors and their advisors to assess differing company approaches thoughtfully. The 2018 Code:

- is shorter and sharper;
- "Supporting Principles" have been removed; and
- has fewer Provisions.

There is a renewed focus on the Principles:

- By reporting on the application of the Principles in a manner that can be evaluated, companies should demonstrate how the governance of the company contributes to its long-term sustainable success and achieves wider objectives.
- The statement should cover the application of the Principles in the context of the particular circumstances of the company, how the board has set the company's purpose and strategy, met objectives and achieved outcomes through its decisions.
- High-quality reporting will include signposting and cross-referencing to other relevant parts of the annual report.

The effective application of the Principles should be supported by high-quality reporting on the Provisions:

- The Provisions establish good practice on a 'comply or explain' basis.
- Companies should avoid a 'tick-box approach'. An alternative to complying with a Provision may be justified in particular circumstances based on a range of factors, including the size, complexity, history and ownership structure of a company.
- Explanations should set out the background, provide a clear rationale for the action the company is taking, and explain the impact that the action has had.
- Where a departure from a Provision is intended to be limited in time, the explanation should indicate when the company expects to conform to the Provision.
- Explanations are a positive opportunity to communicate, not an onerous obligation.

The role of investors and their advisors is very important, and our aim is for the new Code to stimulate dialogue:

- Investors should engage constructively and discuss with the company any departures from recommended practice.
- When considering explanations, investors and proxy advisors should pay due regard to a company's individual circumstances.
- Proxy advisors have every right to challenge explanations if they are unconvincing, but explanations must not be evaluated in a mechanistic way.
- Investors and proxy advisors should also give companies sufficient time to respond to enquiries about corporate governance reporting.

## 1. INTRODUCTION

- 1.1 The review of the UK Corporate Governance Code (the Code) which the Financial Reporting Council (FRC) carried out during 2017 took place against the background of declining trust in big business, the BEIS Select Committee Inquiry and the Government Green Paper, both on corporate governance. Nevertheless, there continues to be widespread recognition of high standards of corporate governance generally in the UK and continued support for the unitary board and the 'comply or explain' approach.
- 1.2 As part of its comprehensive review of the Code, the FRC undertook a series of outreach events to help inform the public consultation which was issued in December 2017. The consultation included a revised Code and Guidance on Board Effectiveness (the Guidance) as well as questions about the future of the UK Stewardship Code. The consultation closed on 28 February 2018.
- 1.3 The feedback statement summarises the main points raised in relation to the consultation questions and the resulting decisions taken by the FRC. We have set out the main points made in relation to these questions and other key matters raised under each Code Section. The feedback statement also includes a table showing how the new Code differs from the 2016 version. A separate document tracks the changes from the version consulted on in December to the new Code.
- 1.4 Throughout the feedback statement, we use the term 'revised Code' this means the version of the Code that was consulted upon in December 2017. The 2018 Code is defined as the 'new Code' and the 2016 version as the 'current Code'.
- 1.5 The FRC received 275 responses from a wide range of stakeholders who expressed a broad spectrum of views. We welcome the contribution from civil society organisations who have not historically responded to FRC consultations. Copies of all responses, with the exception of those that respondents asked to be kept confidential, are available on the FRC website. The split of the public responses is detailed in the table below.

Public respondent by type	Total
Asset manager	20
Asset owner	10
Auditing firm	8
Civil society organisation	25
FTSE 100	25
FTSE 250	9
FTSE Fledgling/Small Cap	5
Individual/s	19
Miscellaneous	18
Professional body	16
Representative body/association – company	18
Representative body/association – investor	14
Service provider/consultant	44
	<b>231</b>

- 1.6 The new Code is a product of judgements we have made and our aim to meet the overall objectives we set in the consultation document. Inevitably it has not been possible to accommodate all views.

- 1.7 The Guidance has been expanded and is intended to support boards and companies to achieve high standards of governance. It contains suggestions and questions to stimulate board discussion. As with the new Code, the board should consider the particular circumstances of the company when thinking about how the Guidance might be used to support its role in effective governance. The Guidance may be useful to all stakeholders when considering the appropriateness of the actions taken by the board.
- 1.8 Overall, respondents felt that the revised Code was a timely and appropriate evolution. Replies were positive, in particular to:
- its streamlined structure and clearer language;
  - the focus on reporting on the application of the Principles;
  - broadening the scope to include wider stakeholders; and
  - its approach to diversity.
- 1.9 There were, though, three significant issues which required further consideration:
- whether we allowed for sufficient flexibility in the methods by which companies should engage with their workforce;
  - the perceived removal of the board's ability to determine independence, alongside the proposals that the chair should be independent throughout their time on the board and that independence would be deemed to end after nine years for both the chair and independent non-executive directors (subject to 'comply or explain'); and
  - clarification of the depth and breadth of the extended remit of the remuneration committee.
- 1.10 Action in light of these issues raised can be seen in paragraphs 2.5-2.12, 2.37-2.52 and 2.83-2.90 respectively.

## **Next Steps**

- 1.11 The new Code will apply to accounting periods beginning on or after 1 January 2019. Therefore, unless companies decide to adopt all or part of the new Code early, the first reporting will not be seen until 2020. Provision 4, however, relates to reporting on significant votes at shareholder meetings and will be appropriate to report on during 2019. Likewise, future remuneration policies and changes to existing ones should be developed with reference to the new Code and the Guidance.
- 1.12 The Financial Conduct Authority is reviewing its Handbook and considering what consequential amendments are needed as a result of the changes to the new Code.

## *Support and Monitoring*

- 1.13 The application of the new Code, how it is used in practice and the quality of reporting are of great importance to improving corporate governance in the UK. We will be monitoring how governance practices and reporting develop in response to the new Code. This will include more in-depth reviews of annual reports to engage with companies on their reporting against the new Code.
- 1.14 Over the coming months the FRC will be embarking on an outreach programme to aid understanding of the new Code by investors and proxy voting agencies and to support its implementation by companies and their advisors.

- 1.15 We expect that some companies will adopt the new Code early and this will help us determine whether additional guidance or support might be necessary. We intend for the Guidance to be more responsive to take account of emerging trends and to offer clarification. It will be kept under review and updated when necessary.
- 1.16 As part of our increased monitoring activities we intend to pay attention to the application of the Principles and compliance with the Provisions, including explanations. In many cases a detailed explanation for not complying with a Provision is more useful to both shareholders and wider stakeholders.
- 1.17 The FRC will be working with stakeholders to embed the new Code and enable the improvements in governance we all wish. After the introduction of the new Code we intend to escalate our monitoring of practice and reporting.

#### *Other Guidance*

- 1.18 We are intending to make the necessary consequential changes to the Guidance on Audit Committees and the Guidance on Risk Management, Internal Controls and Related and Financial Business Reporting over the coming months. For the latter, we will also assess whether amendments are required in relation to internal controls and viability statements, in light of the collapse of Carillon and the completion of the various investigations.

#### *UK Stewardship Code*

- 1.19 This feedback statement also includes a summary of the responses to the high-level questions posed on stewardship as part of the consultation. The UK Corporate Governance and Stewardship Codes complement each other in raising standards of company and investor governance activity to deliver long-term returns to a wide range of stakeholders. We will be consulting on a revised UK Stewardship Code later this year.

## 2. FEEDBACK ON DECEMBER 2017 CODE CONSULTATION

### Section 1 – Leadership and purpose

- 2.1 This section introduced culture and company purpose into the Code reflecting the findings of the FRC's previous work on corporate culture. Although there was not a specific question on the approach to this section there was general support for the broad changes.
- 2.2 This section also supports the changes the Government has made by introducing new regulations which require companies to report on their engagement with stakeholders listed in Section 172 of the Companies Act 2006 (the Act).<sup>1</sup>
- 2.3 Principle A reiterates that a company should generate value for shareholders but goes on to state that companies also have a role in contributing to wider society. Some respondents felt that this was a reinterpretation of s.172 of the Act which states that a directors' duty is to 'have regard' to other matters.
- 2.4 The aim of the new Code is to promote higher standards of governance and we believe that Principle A sets good practice in this area. Nothing in this new Code overrides or is intended as an interpretation of the statutory statement of directors' duties in the Act.

### **Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?**

- 2.5 The Government asked the FRC to consult on introducing a new Principle establishing the importance of engagement with non-shareholders and a Provision strengthening the connection between boardrooms and employees. The latter indicates that companies should adopt, on a 'comply or explain' basis, a choice from three engagement methods. These methods were included in the revised Code.
- 2.6 Almost all responses to the consultation supported engaging with the workforce and many companies gave examples of the methods they currently use to demonstrate that there are other ways to achieve effective engagement. A small number stated that the three named methods were the right ones and felt that companies would naturally choose one of the three suggested methods.
- 2.7 Many felt that the three methods were too restrictive and, although it was recognised that the revised Code was 'comply or explain', many felt that the drafting could be interpreted as a requirement to use one of the listed methods.
- 2.8 Several responses highlighted the importance of trade unions and suggested that those companies with union representation could draw on this relationship to achieve workforce engagement. These responses also advocated workers on boards, along with ensuring that there is union representation on worker advisory panels. Importantly, it was clear that any workforce engagement method should not replace existing union structures.
- 2.9 Respondents also explained that when dealing with a global workforce different forms of engagement are used which would not necessarily be the same as the options in the revised Code.

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<sup>1</sup> The Companies (Miscellaneous Reporting) Regulations 2018.

- 2.10 The use of the word ‘normally’ to confirm that companies could, on a ‘comply or explain’ basis, undertake other methods of engagement received a mixed response. Some respondents thought it was helpful and others felt that it was confusing. This linked to concerns that the Guidance appeared to suggest there was more flexibility than the three methods proposed.
- 2.11 There were requests for further clarity on the definition of ‘workforce’ and some concerns were raised that the term could be confused with other ‘workforce’ or ‘employee’ definitions used within legislation or in relation to company taxation.
- 2.12 A number of responses thought that the revised Code gave more emphasis to engagement methods than ensuring that the board received the information and was able to incorporate the views of the workforce into their decision-making process.

#### Our Response

The FRC supports the Government’s three primary options for engaging with the workforce, while also recognising that there may be other effective methods along with those already in place in companies which achieve such engagement. To ensure that any additional methods used are effective we have explicitly required in Provision 5 that companies explain the method and its effect. Methods should also be kept under review to make sure they remain effective.

Provision 5 also clarifies that companies should understand the views of other key stakeholders and then goes on to require specific methods of engagement for the workforce. The wording has also been amended to require companies to explain how the interests of stakeholders have influenced the board including a requirement to explain how interests and matters have been considered in decision making.

The Guidance gives a description of ‘workforce’ for the purposes of engagement.

#### **Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?**

- 2.13 Almost all responses recognised the importance of sustainable development and the consideration of these issues alongside business planning and developing company purpose.
- 2.14 Some responses explained what measures companies were considering which aligned with this agenda. Civil society organisations were keen to see a reference to the UN SDG’s in the new Code alongside a reference in the Guidance. The majority of responses felt that including such references in the new Code would not appropriate.
- 2.15 Many responses raised concerns in relation to referencing one set of principles – the UN SDGs – and not including other frameworks or principles, for example the Taskforce on Climate-related Financial Disclosures (TCFD). This coincided with concerns raised that guidelines often change and evolve and therefore making reference to specific ones within the new Code risks that others are overlooked.
- 2.16 Many cautioned that the new Code should not prescribe a specific framework or set of principles for companies to follow. This should be a decision for the board to make based on the business plan, sector and type of business.
- 2.17 Although a majority of responses were not in favour of reference to UN SDGs and NGO principles in the new Code, a majority thought that it would be useful to reference these and other frameworks within the Guidance.

## Our Response

In line with the Government's recent response to the Advisory Group on 'Growing a Culture of Social Impact Investing in the UK' and taking account of the consultation responses, the FRC considers that the most appropriate place to make reference to UN SDGs or other frameworks is within the Guidance.

In line with the majority of responses, the Guidance highlights some of the current frameworks and principles, including UN SDGs. The decision on whether to align company strategy to any of these frameworks will be for the board to determine as will the extent to which it reports against the framework.

### **Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?**

2.18 Responses to this question were mixed. Although a number of responses felt that a 20 per cent vote against was an arbitrary figure the majority recognised that, with the introduction of the Investor Association Public Register, the revised Code was in line with this.<sup>2</sup>

2.19 A number of responses asked for clarity in two areas. Firstly, that it was votes cast against a board recommendation and second that the precise figure be 20 per cent or more.

2.20 Many of the responses challenged the need for a six month update if there was a 20 per cent vote against. Some felt that six months was too long, others felt there would be little detail at six months or that boiler-plate reporting would be the result. However, there were still many, including investors, who supported this approach and felt that six months was sufficient time to engage.

## Our Response

Provision 4 confirms that an explanation is required when 20 per cent or more votes are cast against a resolution recommended by the board.

We have retained the requirement for an update at six months, which should cover the views received and any actions taken. This report is to ensure that companies demonstrate that dialogue is ongoing and note any actions and outcomes. In some cases actions may still be ongoing and can be reported on accordingly.

### **Other significant Section 1 changes**

#### *Culture*

2.21 In response to comments that aspects of Provision 2 on culture were drafted in the manner of a Principle we have made some changes to the language used.

2.22 We have also moved from the remuneration section wording on reporting details of the company's approach to investing in and rewarding its workforce as it is more appropriate in Provision 2.

<sup>2</sup> Details of significant votes against and related company updates are available on the Public Register maintained by The Investment Association – [www.theinvestmentassociation.org/publicregister.html](http://www.theinvestmentassociation.org/publicregister.html)

## *Whistleblowing*

- 2.23 Some concerns were expressed in relation to the drafting of Principle D and whether the words 'management and colleagues' could result in a narrow interpretation of the whistleblowing Principle.
- 2.24 Principle E now states that the workforce should be able to raise matters that appear inconsistent with company values and long term-success. The whistleblowing wording has also been de-coupled from the stakeholder and workforce engagement provision.

## **Section 2 – Division of responsibilities**

- 2.25 The changes made in relation to independence generated a significant number of comments, which can be broken down into three main areas:
1. board discretion when determining the independence of a non-executive director;
  2. whether the chair should be considered independent throughout their service rather than 'on appointment'; and
  3. how the determination of 'independence' affected the make-up of board committees.
- 2.26 In this section we also proposed removing all smaller company exemptions. Feedback was not entirely clear as the consultation question focused solely on external board evaluation, and yet the proposed changes also impact annual election and the overall composition of the board and its committees.

### **Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.**

- 2.27 Many responses pointed out that there is nothing to prevent a smaller company from having an externally facilitated board evaluation, although others pointed out the high costs involved.
- 2.28 Along with the cost of an external board evaluation, responses noted that there are other hidden costs which need to be taken into account, specifically the time commitment for board members. Adding additional costs and obligations on smaller, growing companies may ultimately impact their decision to remain in a regulated market and thus access to a deeper pool of potential investors. This could also reduce the pool of potential investments open to investors whose mandates require investment on regulated markets only.
- 2.29 There were also concerns expressed that the market is not fully developed and that there is not an adequate pool of organisations providing board evaluation services to support an extension of this requirement.
- 2.30 We recognise that these comments in relation to costs and burdens should be balanced against the impact that high-quality effectiveness reviews can have on raising the standards of governance.

## *Annual elections*

- 2.31 Some responses highlighted various risks including that this would divert board focus from other issues, increase the number of resolutions that investors had to vote on, and raised concerns of what might happen if all directors were not re-appointed by shareholders.

2.32 This change for FTSE 350 companies was originally introduced in 2010 and while there has been some opposition seen in votes against individual directors, there has been no widespread opposition to the re-appointment of directors, which was a fear that had been raised at the time.

#### *Board and committee composition*

2.33 The effect of the December consultation proposal that the chair should be considered independent throughout their service and not on appointment only (as in the current Code) meant that smaller companies could have included the chair when meeting minimum independent directors requirement for the composition of the board and committees.

2.34 Some respondents pointed out that the removal of the exemptions relating to board and committee composition for small companies might necessitate hiring an additional non-executive director which would increase costs to smaller companies.

2.35 In addition, it was suggested that there could be wider implications, as many institutional investors are seeking to limit the number of roles non-executive directors accept.

#### **Our Response**

Our goal here was to improve the overall effectiveness of boards – regardless of the size of the company. While smaller companies could provide an explanation, we have listened to the concerns voiced in many of the responses that removing all the exemptions would mean that companies may feel increasingly obliged to meet criteria which could prove unduly onerous for smaller firms. As such, we have:

- removed the smaller company exemption regarding overall board composition, as consulted on in December, in order to encourage sufficient independent challenge;
- returned to the current Code wording in relation to overall board composition which says that 'at least half' rather than 'the majority' of the board need to be independent non-executive directors; and
- reverted to the membership of the audit and remuneration committees remaining as two independent non-executive directors to permit flexibility for smaller companies.

In order to reinforce the independence of the audit committee, the element of the Provision enabling independent chairs of smaller companies to be a member has been removed. If there is a strong case for any company chair to be a member then an explanation can be provided. We are aware that some company chairs attend meetings as an observer.

In Provision 21 we have included wording to encourage all chairs to consider the use of externally facilitated board evaluations rather than make it an absolute requirement for smaller companies. This is a response to concerns that there is insufficient capacity in the current board evaluation market.

For all companies that have external board evaluations we have added to the nomination committee reporting (Provision 23) that 'the nature and extent of an external evaluator's contact with the board and individual directors' should be recorded. This is because 'external' evaluations can be limited to questionnaires only, and do not necessarily involve interviews with individual directors or attendance at board meetings.

**Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?**

**Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?**

2.36 As noted above, the responses to these questions were wide-ranging and overlapping, therefore we have dealt with them together.

#### *Board to determine independence*

2.37 The current Code lists 'independence criteria' (B.1.1) but allows the board to determine who they consider a non-executive director independent 'notwithstanding' the list. The revised Code removed this discretion and stated that non-executive directors were no longer considered independent if any of the criteria applied to them.

2.38 Although the revised Code continues to be applied on a 'comply or explain' basis, the majority of the respondents raised multiple concerns with this change of approach. Many stated that the list was not exhaustive and did not consider many other situations where independence could be impaired, and therefore the list was arbitrary.

2.39 Others felt that the list of criteria needed further explanation if the decision was a binary one, for example what is meant by 'close family ties'. It was argued that currently this does not pose a problem as the board can consider many family relationships and determine whether the non-executive director is independent.

2.40 In addition, it was felt by some that 'hardwiring' the 'independent non-executive directors' label would result in poor governance decisions rather than choosing to explain.

2.41 There was some support for the new approach, but these views were very much in the minority.

#### *Chair Independence*

2.42 The revised Code proposed that the chair should no longer be considered 'independent upon appointment' and should also fulfil the B.1.1 criteria throughout their tenure period.

2.43 The majority of responses explained that the chair holds a unique position in a company where they become closely involved with a company's executive directors and senior management. Respondents stated that despite this unique position chairs remain independent of mind.

2.44 Indeed, many suggested that it would be impossible for a chair to effectively carry out their role without spending a significant amount of time at the company and taking on a leading role within the company.

2.45 Several responses also noted that the proposed change to status of the chair is at odds with the Higgs Review which stated that 'once appointed the chair will have a much greater degree of involvement with the executive... Applying a test of independence at this stage is neither appropriate nor necessary'.

### *Chair limited to tenure of 9 years*

- 2.46 By proposing that the chair would no longer be 'independent on appointment' the chair would be subject to the 'independence criteria' which would restrict tenure to nine years, on a 'comply or explain' basis.
- 2.47 We were aware that by applying the independence criteria in the revised Code to chairs, we were introducing a tenure period to which chairs are not subjected to under the current Code.
- 2.48 A number of respondents observed that this was a significant change and that it would take some time to remove all chairs currently in post for longer than nine years, which would have a significant effect on a number of companies.
- 2.49 It was also noted that there may well be sound reasons why a chair should remain in post beyond nine years.
- 2.50 Some respondents were concerned that the change could have a negative impact on board diversity. They suggested that the proposed change could discourage internal appointments and therefore, inadvertently, make it less likely that a female chair would be appointed.
- 2.51 This would also apply to male chairs who were 'promoted' from a company board to the same company chair. We are, however, aware that more men than women secure a role as chair without previous experience on the same company board.
- 2.52 Many responses urged us to tackle the issue of succession planning and effective board composition more strongly. In addition, the issue of board competence was raised with us during our outreach and has since been highlighted as a significant issue in relation to the collapse of Carillion.

#### **Our Response**

The proposed changes were made with the intention of encouraging board refreshment and diversity. We still wish to achieve this outcome and believe that additional measures are required beyond the current Code's approach.

As stated in the consultation, while the current Code does not refer to tenure, we are aware that many companies and investors have used the 'nine-year' criterion for independence as a 'de facto' tenure period. This is the right approach, and in normal circumstances we would not expect either an independent non-executive director or chair to be on a board for more than nine years in total, including in those circumstances where an independent non-executive goes on to be the chair.

We recognise the 'special' role of the chair, the close involvement with the company and close relationship with the executive throughout their tenure. We have therefore, reverted to the approach in the current Code for the chair to be 'independent on appointment' and amended Principle F second sentence to read – *'The chair should demonstrate objective judgement throughout their tenure...'*.

We have added a new Provision regarding tenure of the chair in Section 3. This includes wording to deal with an existing non-executive director who has been appointed chair. Time served will count towards the nine years and will reduce the time they can serve as chair. The Provision permits a limited extension to the term of the chair beyond nine years if they are already a board member and the appointment supports the company's succession plan and diversity policy.

In addition, we have inserted '*length of service of the board as a whole*' into Principle K, to link with the requirement to consider each directors contribution as part of the evaluation requirement.

We have also reinstated board discretion, albeit we expect to see greater detail when companies report on the independence status of these board members.

## **Other significant Section 2 changes**

### *'Overboarding'*

2.53 In response to comments concerning non-executive directors holding multiple directorships ('overboarding') we have amended Provision 15. We want both boards and directors to think carefully about the commitments they make when taking on new appointments.

2.54 To counteract any risk of boiler-plate reporting, the Provision requires that only 'significant appointments' should be reported upon. These will vary depending on the companies and roles involved. The nature and extent of all the individual director's commitments should be considered when reaching a decision on what to report.

## **Section 3 – Composition, succession and evaluation**

2.55 The proposals for Section 3 of the revised Code reflected the pre-consultation feedback we received about the need to improve nomination committee practices and reporting, particularly on diversity and succession planning.

### **Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?**

2.56 Overall the responses were supportive of the approach to diversity taken in Section 3 and many respondents welcomed the proposed new emphasis on diversity in the revised Code.

2.57 Many responses, particularly those from companies, their advisors and investors, stressed that directors should be appointed on merit regardless of other characteristics; there was some support for strengthening Principle J in this regard. Although there was a general view that diversity should not override a merit-based assessment, responses were generally comfortable with the language in Principle J.

2.58 Responses particularly welcomed the link between diversity and strategy and the wider remit of the nomination committee. The majority of responses supported a focus on development of individuals below board level and succession planning as a way to increase diversity in the executive pipeline and improve levels of diversity in senior management and the boardroom. Some respondents suggested that the focus should be on the whole organisation rather than specifically on the executive pipeline.

- 2.59 Respondents emphasised the importance of succession planning and some suggested skills matrices were an effective tool for mapping skills gaps. The appointment process and board evaluations were also singled out as areas for attention, as was the importance of securing middle management support for diversity initiatives.
- 2.60 A number of respondents considered that the fourth bullet of Provision 23 asking nomination committees to give “*an explanation of how diversity supports the company in meeting its strategic objectives*” was unclear and would be difficult to report against. They suggested that the Provision needed to be more specific about what was required. There was a view among some respondents that wording closer to the current Code and the new diversity reporting requirement in the Disclosure Guidance and Transparency Rules (DTRs) would be preferable and encourage more meaningful diversity reporting.<sup>3</sup>
- 2.61 Some of responses expressed a preference for the definition of senior management used throughout the revised Code to be expanded to the first layer of management below the board and their direct reports, often referred to as the ‘Hampton-Alexander definition’.

#### Our Response

Given the overall positive response to the approach taken to diversity in Section 3 of the revised Code, we have made limited change to the proposals. Provision 23 has been clarified and aligned more closely with the reporting requirement in the DTRs. We have also expanded the reporting on board evaluations to ask that more information be provided.

The definition of senior management in the new Code was a conscious choice. We do not consider it appropriate to include direct reports in the definition used in the new Code other than for the purposes of reporting on gender diversity in the executive pipeline (Provision 23). It is not the intention that the board and its committees should be involved in the appointment or remuneration of those individuals who report directly to the first layer of management below board level.

We are aware that the Government has recently introduced legislation to require companies with more than 250 employees to report on their gender pay gap. We have included wording in the Guidance to encourage boards and their committees to think about how the gender pay gap is being addressed.

#### **Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.**

- 2.62 The overwhelming majority of respondents supported the proposal to extend reporting on the gender balance of the executive committee and their direct reports, to all companies with a premium listing.
- 2.63 Respondents agreed that the focus on the executive pipeline is critical to improving the diversity of leadership in UK companies and reaping the benefits of having more women leaders. A number of responses pointed out that a diverse pipeline is important for all companies, regardless of size. Some pointed out that extending this below the FTSE 350 requirement could help strengthen the overall talent pipeline, with one respondent pointing out that what gets measured tends to get managed.

<sup>3</sup> DTR 7.2.8.A.

- 2.64 Of those who commented, most felt that this reporting would not impose a significant cost or burden on business, given the small numbers of employees covered and payroll data which already identifies gender.
- 2.65 A small number of respondents were unclear that the proposal related only to the specific Hampton-Alexander recommendation on the reporting of gender balance in senior management. They stressed that, while they could support this specific extension, they would not support extending the other Hampton-Alexander recommendations to companies below the FTSE 350. A few responses suggested that additional reporting should be phased in for these companies.
- 2.66 One respondent pointed out that including this reporting requirement in the nomination committee report could lead to duplication of information in the Strategic Report.

#### Our Response

Taking account of the strong support for this disclosure, no changes to the proposal have been made. Provision 23 asks all companies applying the new Code to disclose the gender balance of those in the first layer of management below board level and their direct reports.

We acknowledge that this could lead to duplication of information in annual reports. However, we consider that consistency in the way this is reported will provide meaningful data which can be tracked over time to help companies assess whether attempts to improve gender equality are succeeding. Given that, in 2017, only 21% of the FTSE 350 gave their definition of senior managers in their most recent annual report and the lack of consistency in those definitions, we believe that the additional disclosure in the nomination committee's report will be useful. We would encourage companies to think about how they can avoid duplication, for example through the use of signposting or alignment of definitions.

#### **Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.**

- 2.67 The majority of respondents supported greater transparency in respect of different aspects of diversity in principle. There was a broad-based view that the availability of information tends to increase internal focus and can help drive change.
- 2.68 Respondents pointed out that diversity is a broad concept and felt that the Code should encourage an inclusive approach rather than focusing on a single dimension.
- 2.69 Many responses highlighted the significant challenges and practical difficulties with collecting ethnicity data, which could affect the usefulness of such information.
- 2.70 A majority of respondents preferred encouragement and voluntary reporting to mandatory reporting. A small number of responses disagreed with this view and felt that Provision 23 should include ethnicity data alongside gender data.
- 2.71 Some responses suggested it would be more useful for companies to disclose policies and practices, actions taken and their impact, rather than numbers.

#### Our Response

Taking account of the majority of responses, we have not added a further reporting requirement to the new Code. Given the broad support for encouragement, however, we have included wording in the Guidance to encourage companies to think about providing more information about different aspects of diversity in their workforce, other than gender. The FRC has been assessing diversity reporting against the current Code and will publish the findings in the autumn. We are considering what follow-up work might be appropriate as part of our future monitoring once the new Code takes effect.

#### Section 4 – Audit, risk and internal control

- 2.72 There is little change in this section from the current Code as updates had been carried out in 2014 and 2016 to take account of the Sharman Report and the EU Audit Regulation and Directive and respectively.
- 2.73 The consultation on this section of the revised Code looked to confirm that respondents were content to retain the duplication with the requirements within the Listing Rules (LR), the DTRs and the Act. We also asked if there were issues with transferring to the Guidance the requirement to publish the audit committee terms of reference – along with those of all board committees.

#### **Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?**

- 2.74 A clear majority of responses agreed that the right approach was to retain the duplication. It was noted that such duplication acts as a prompt for companies and that many companies other than those with a Premium listing also make use of the current Code.
- 2.75 A number of points were made about the viability statement, with some respondents noting that the commentary in paragraphs 75-79 of the consultation document and references to the FRC Lab report were useful. Views were also expressed in relation to the effectiveness of the viability statement in the wake of the Carillion liquidation. The FRC and other regulators are currently investigating the collapse of Carillion. In light of these investigations should there be a need to propose amendments to this section of the new Code, the LRs, or other legislation, a further consultation will be undertaken.
- 2.76 Some of the respondents questioned whether risk should be dealt with by a specific risk committee and whether the Code should require one. Others queried whether this Section included too much on audit and needed more on risk.
- 2.77 A number of respondents drew our attention to the links between Sections 1 and 4 and how risk and effective controls underpin long-term sustainable success.

#### Our Response

We have retained most of Section 4 including duplication with the LRs and DTRs and reintroduced some elements which were missing from the current Code. We have included some additional references to risk and emerging risks in the new Code, and the Guidance discusses risk in more detail than the version consulted on. Section 1 now includes wording in Principle C relating to risk management.

We have not included specific reference to a risk committee, but the Guidance makes it clear that risk issues can be dealt with by a risk committee and this is a decision for the board if the company is not legally required to have a risk committee.

A table in Appendix B of the Guidance shows the overlaps between the LRs and DTRs.

**Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.**

2.78 A clear majority of respondents agreed to the removal of C.3.3 in the current Code – namely that ‘the terms of reference of the audit committee, including its role and the authority delegated to it be the board, should be made available.’

**Our Response**

We have moved this requirement into the Guidance. This is in line with the terms of reference of the other committees within the new Code. Provision 25 continues to set out the main roles and responsibilities of the audit committee.

**Section 5 – Remuneration**

2.79 The Government asked the FRC to consult on giving remuneration committees a broader responsibility for overseeing pay and incentives across their company and requiring them to engage with the workforce to explain how executive remuneration aligns with wider company pay policy (using pay ratios to help explain the approach where appropriate).

2.80 It also asked the FRC to consult on extending the recommended minimum vesting and post-vesting holding period for executive share awards from three to five years to encourage companies to focus on longer term outcomes in setting pay.

2.81 We proposed a number of other changes, including emphasising the link between executive remuneration and long-term thinking, to encourage innovation in remuneration scheme design, and to stimulate the exercise of discretion to adjust remuneration outcomes where these would otherwise not reflect individual or underlying company performance.

2.82 In 2017, the Government also consulted on requiring remuneration committee chairs to have served for at least 12 months on a remuneration committee before taking up the role. Most respondents to that consultation agreed that at least 12 months’ prior experience on a remuneration committee was desirable before taking up the role of chair. A majority of business and investor respondents felt this should be introduced on a ‘comply or explain’ basis through the Code rather than through legislation as this would provide for flexibility to respond to a range of circumstances.

**Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?**

2.83 All respondents agreed with the idea that the remuneration committee needs a sound understanding of pay and reward across the organisation so that remuneration committees are able to take this broader context into account when making decisions on executive and senior management remuneration. Some responses considered that greater consistency between executive remuneration policy and wider company pay

policy was desirable, and a number referred explicitly to the importance of fair outcomes across the company.

- 2.84 The main area of disagreement related to the depth and breadth of the remuneration committee's role with respect to workforce remuneration. Many respondents sought clarification about the boundaries around the remuneration committee's role. Some respondents interpreted the term 'oversight' to mean the remuneration committee would be expected to set and approve workforce policies, effectively being drawn into a quasi-executive function and blurring the distinction between the board and management.
- 2.85 Respondents also felt that the phrase 'workforce policies and practices' was broad and ambiguous. There was a strong preference from respondents for the focus of the remuneration committee's role to be limited to remuneration-related matters.
- 2.86 It was highlighted that there appeared to be more flexibility in the Guidance to delegate oversight than suggested by the revised Code. This created some confusion about where responsibility for 'workforce policies and practices' reside.
- 2.87 Companies highlighted that, in many cases, it would not be practical in a global business for the remuneration committee to oversee the complexities of pay practices across different jurisdictions, subject to different local laws, regulations and customs. They also expressed concern about potential legal and practical difficulties with overseeing remuneration for those without contracts of employment.
- 2.88 Companies were concerned that the proposed remit for the remuneration committee could have increased demands on committee members' time and make it difficult to attract non-executive directors to the role of remuneration committee chair.
- 2.89 Some companies disagreed with the proposal that the remuneration committee should set senior management pay claiming this would undermine the chief executive.
- 2.90 A few responses sought to clarify whether the intention was for the remuneration committee to set the pay for all non-executive directors in future as the revised Code proposals did not address this issue.

#### Our Response

The FRC supports giving remuneration committees a wider remit. Our intention was to broaden it in a manner that was consistent with a non-executive role. We have, therefore, clarified the boundaries of the remuneration committee's remit in several respects.

Principle E now assigns the overarching responsibility for 'oversight of workforce policies and practices' to the board, therefore removing this from the remuneration section of the new Code. The board will monitor the implementation of workforce policies including those related to remuneration, as part of its monitoring of culture under Provision 2 – this was previously in the fifth bullet of Provision 41.

Provision 33 clarifies that the remuneration committee only has responsibility for remuneration-related matters and that its remit will be limited to reviewing 'workforce remuneration and related policies'. The Guidance provides further assistance.

We are persuaded that the remuneration committee's review should cover those sections of the workforce whose pay and conditions are under the company's control. The Guidance gives a description of 'workforce' for the purposes of remuneration.'

As regards the setting of senior management pay, our understanding is that many remuneration committees already do this and, on balance, we consider it to be an appropriate part of the role.

Provision 34 now covers the remuneration of non-executive directors which should be decided in accordance with the Articles of Association and where this is silent, the board.

**Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?**

- 2.91 This was a purposefully open question and drew many interesting suggestions. The responses to this question underlined the importance of scheme design in encouraging long-term thinking and achieving outcomes that command respect while supporting and driving the right behaviour.
- 2.92 Respondents were divided about the relative proportions of fixed and variable pay. Some expressed doubt, however, about the incentive value of schemes that pay out over long periods. Others pointed out that the average tenure of chief executives is less than five years and that this should be a factor when designing schemes.
- 2.93 There appears to be a widespread perception that executive remuneration is failing to act as a tool to incentivise performance and that the complexity of the system is creating a growing reputational risk for companies and investors alike.
- 2.94 Many respondents were concerned about the increasing uniformity of packages, consisting of salary, bonus and long-term incentive plan (LTIP). The latter were considered by many to be complex while delivering poor correlation between company performance and remuneration outcomes and failing to demonstrate the link to long-term value.
- 2.95 There was significant support for encouraging innovation in scheme design and the use of simpler schemes as alternatives to LTIPs. Some respondents expressed frustration with investors, who are seen as resistant to new ideas and change.
- 2.96 Many respondents suggested that, where long-term incentive plans were used, an important way to link remuneration to long-term sustainable success was through the choice of performance conditions. There was widespread support, including from some investors, for encouraging remuneration committees to adopt a broader range of performance measures linked to strategy, including non-financial metrics, and discouraging the use of traditional financial measures linked to the capital markets, such as Earnings per Share and Total Shareholder Return.
- 2.97 Most respondents supported a vesting and holding period of five plus years with a small minority believing this to be too inflexible. Some sought a clarification that this was intended to be a five year period in total; others wanted clarity in respect of averages, phased awards and deferred annual bonuses paid in shares. There was also support for post-employment shareholding requirements as a way of stimulating long-term thinking on the part of executives.
- 2.98 The guiding framework set out in Provision 40 was generally welcomed, including by companies, with some support for strengthening it. Companies were keen that the Code allow flexibility and the ability to set pay structures appropriate for their business.
- 2.99 Finally, some respondents requested that the Code be more specific about the expectations in respect of executive pension arrangements.

## Our Response

The FRC considers that the Code should be non-prescriptive on the structure of remuneration schemes and should avoid encouraging companies, explicitly or through implication, to adopt any one form of scheme over others, for example LTIPs rather than restricted shares. We have amended the new Code to remove language which could be perceived to be encouraging LTIPs.

We have made several other changes to address the various issues raised in the responses, allowing flexibility for companies to design bespoke arrangements while also encouraging innovation and alternatives to the commonly adopted base pay, bonus, LTIP approach.

We note that in their 2017 strategic reports, only 20% of the FTSE 350 discussed the link between strategy and remuneration and that 37% made no use of non-financial metrics for performance-related remuneration, suggesting that more can be done to improve the design and effectiveness of schemes.

Provision 36 clarifies the situation with respect to phased awards and total vesting and holding periods. Total vesting and holding periods of five plus years apply to share awards granted to executives; this would not include deferred elements of annual bonuses, which typically vest over a shorter period.

Provision 36 also now includes stronger language with respect to post-employment shareholding requirements. Remuneration committees are expected to have a formal policy in place.

Provision 38 clarifies expectations with respect to pensions. It has been common in the past for executive directors to be offered more generous arrangements compared to other employees, although the rationale for this has often not been obvious. The new Code is now clear that executive pension contributions should be in line with those available to the rest of the workforce.

Provision 40 now includes risk as a factor to be addressed in scheme design and asks remuneration committees to think about limits and discretions when addressing predictability.

A specific reporting requirement has been added to Provision 41 to encourage remuneration committees to explain how they have addressed the factors in Provision 40.

### **Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?**

2.100 The responses to this question were mixed, reflecting the level of uncertainty around the impact of the changes in respect of the exercise of discretion. Overall the requirement for an ability to override formulaic outcomes as set out in Provision 37 was overwhelmingly welcomed.

2.101 Nearly half of all responses were hopeful but unsure to what degree the changes would make a difference. The most commonly cited reason for a negative response to this question was that investor pressure would be the main driver. Others considered that the revised Code changes could make a difference by empowering remuneration committees, by encouraging them to revisit existing schemes and policies to ensure the use of discretion is permitted, and by leading to more scrutiny of their actions.

2.102 FTSE 100 companies were most likely to agree the changes would help while companies in the FTSE 250 were not confident they would.

- 2.103 Some respondents were confused about where the responsibility to exercise discretion lay, with the board as suggested in Principle Q or with the remuneration committee.
- 2.104 Others commented on the ability to exercise discretion, expressing concern that this could be seen as moving the goalposts retrospectively. They were keen that it should be explicit that this was not unlimited. A few responses suggested we should qualify the use of discretion, for example with the term 'reasonable' or 'in a responsible way'.
- 2.105 A number of respondents pointed out that employment contracts and scheme rules can prevent the exercise of discretion in practice, even if the remuneration policy permits it.
- 2.106 The role of shareholders was another theme that came through quite strongly, as it did with question 15; a number of respondents stressed the importance of engagement and accountability to help shareholders understand how discretion would be used.
- 2.107 A minority of responses commented on the proposal that the remuneration committee chair should serve 12 months on a remuneration committee before becoming chair. There was support in principle for this proposal. A few respondents suggested it would be preferable to require the chair to have relevant experience, for example in HR or as a remuneration consultant; others felt the chair should have to serve on the remuneration committee of the same company before becoming chair.

#### Our Response

We are clear that the responsibility for exercising discretion over executive remuneration outcomes lies with the remuneration committee and the need to do so should be considered in the course of its annual decision-making process. Principle R and Provision 37 have been amended to remove the suggestion that the responsibility lies with the board.

The board's responsibility for workforce policies and practices as set out in Principle P has been moved to Section 1 of the new Code. Principle P now focuses on the need to link strategy, long-term success and executive remuneration. A perception of poor correlation between company performance and executive remuneration has contributed to rising shareholder dissatisfaction with remuneration outcomes. At the same time, where short-term shareholder returns are the main driver of the policy, this can incentivise behaviour which is harmful to long-term success.

With respect to the extent of any discretion to be exercised by remuneration committees, Section 24 part 4 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 states "*where any provision of the directors' remuneration policy provides for the exercise by the directors of a discretion on any aspect of the policy, the policy must clearly set out the extent of that discretion in respect of any such variation, change or amendment.*"

In view of the statutory requirement and other checks on the remuneration committees, such as board endorsement, the need to treat executive directors fairly and to retain credibility with shareholders, the FRC considers the risk that remuneration committees will regard discretion as unlimited to be low. We are also aware that some FTSE 100 companies have already embedded the concept of reasonable discretion in their remuneration policies. We have therefore decided not to qualify discretion in Provision 37.

It is important to understand the difference between malus and clawback, and discretion. The circumstances in which the former can be invoked are specified in advance and usually embedded in individual contracts. The use of malus and clawback tends to be reserved for extremely serious events. On the other hand, discretion is likely to be exercised in a wider range of circumstances than originally foreseen.

Accordingly, it is not possible to pinpoint in advance the precise circumstances in which it might be used. Our expectation is that remuneration committees will consider annually as a normal part of the process to determine remuneration outcomes, whether there are circumstances which warrant the exercise of discretion.

We are concerned by reports that contractual obligations and scheme rules can undermine the remuneration committee's ability to use discretion. We consider that remuneration committees have a responsibility to ensure that the different elements of the framework interact in such a way that the intent of the remuneration policy is not undermined. The new Code changes are intended to encourage remuneration committees to pay attention to this. Provision 41 has been amended to require disclosure of the reasons for applying discretion to remuneration outcomes. We would expect this to include disclosure of anything that prevents its use where outcomes would otherwise have been adjusted.

### **3 FEEDBACK ON THE REVISED GUIDANCE ON BOARD EFFECTIVENESS**

- 3.1 We received many comments and suggestions on the revised Guidance across a wide range of issues. The majority of responses welcomed the way in which the Guidance had evolved. Respondents found the use of ‘questions for boards’ particularly helpful.
- 3.2 Many responses considered that the status of the Guidance needed clarifying. Some felt that the language was too prescriptive in some parts, leading to concern that the Guidance might be viewed as a set of requirements. At the same time, there was support for cross-referencing and signposting in the Guidance and for emphasising that the Guidance should be used alongside the new Code.
- 3.3 The majority of the comments received were on section one of the Guidance. Themes that came through most strongly related to the balance between the focus on strategy versus the focus on stakeholders and culture, and the interpretation of section 172 of the Companies Act. Other areas that received particular attention were board evaluations and remuneration.
- 3.4 Key changes that have been made in response include:
- Changes to the language so that the tone is less prescriptive – ‘should’ is now mainly used for those elements moved from the current Code or which are directly related to a specific Principle or Provision.
  - Changes to the introduction to emphasise the importance of the Guidance in promoting high standards and to encourage its use of alongside the new Code.
  - Signalling the intent to update the Guidance more frequently as practice develops.
  - Referencing through footnotes, the Principles and Provisions related to the content of the Guidance.
  - Changes to section one of the Guidance to adjust its focus and embed the themes more effectively.
  - Moving the board’s responsibility for workforce policies and practices from section five to section one, in line with corresponding changes to the new Code.
  - A new section on externally facilitated board evaluations in section three.
  - Changes to section five to reflect changes made in the new Code and other feedback on remuneration.
  - Addition of an appendix showing the overlaps between the new Code and Financial Conduct Authority’s Handbook.

## 4 SUMMARY OF INITIAL CONSULTATION OF UK STEWARDSHIP CODE

- 4.1 As part of its consultation on the UK Corporate Governance Code, the FRC also included some initial questions on the future of the UK Stewardship Code (the Stewardship Code).
- 4.2 The Stewardship Code seeks to secure long-term value by enhancing the quality of engagement between investors and companies to improve long-term risk-adjusted returns to shareholders.
- 4.3 Evidence from surveys, discussion with market participants, and assessment of statements from signatories to the Stewardship Code show there has been an improvement in the quantity and quality of engagement with companies since it was introduced. However, the Stewardship Code was last reviewed in 2012 and we wish to consider the role it could play in driving improved outcomes in stewardship practice.
- 4.4 There were 109 responses to the consultation questions on the Stewardship Code. Overall, respondents to the consultation recognised the role the UK played in influencing stewardship practice and were positive about the prospect of a strengthened Stewardship Code as an opportunity to lead international good practice. A summary of responses to the consultation questions can be found below.
- 4.5 The feedback to these initial questions on the Stewardship Code will inform the development of a revised Stewardship Code for public consultation later this year.

### **Q17: Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?**

- 4.6 While some respondents felt that the current Stewardship Code is working well and saw no need for significant changes, the majority agreed that it would be helpful to have clearer expectations of the stewardship roles and responsibilities of those at different points in the investment chain. However, there was very little support for introducing separate codes for asset owners, asset managers, proxy advisors and investment consultants. A clear majority of responses favoured the FRC maintaining a single Stewardship Code with supporting guidance for the different stakeholders. Many respondents called for specific attention to be paid to the role of proxy advisors.

### **Q18: Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?**

- 4.7 Many respondents agreed that it would be helpful to reformat the Stewardship Code so it was similar to the UK Corporate Governance Code – with principles, provisions and supporting guidance. Some respondents acknowledged that establishing a principles and provisions structure would help asset owners in establishing benchmarks when evaluating fund manager performance as part of their due diligence and monitoring process.
- 4.8 While many agreed that a 'comply or explain' structure is a good approach, other respondents noted best practice stewardship is constantly evolving, and raised concerns that by closely defining expectations the Stewardship Code could risk stifling innovation. Many suggested using supporting guidance to highlight examples of a range of good practice, rather than a single best practice.

- 4.9 For some topics it was generally considered easier to define good practice, for example stock lending and the use of external advisors. Other areas clearly present more challenges, particularly in accommodating the wide variety of investment approaches, styles and goals across the market. Where respondents were in favour of defining good practice, they suggested using the knowledge gleaned from the FRC's tiering process and leveraging the work done by other bodies such as the UN PRI and academic research, alongside a broad consultation with all parts of the investment chain to build consensus on what those practices might be. A few respondents were strongly against the idea of defining best practice, stating if role expectations were more clearly defined (as per Q17) they would prefer to maintain the flexibility of the current Code, which they feel allows signatories to explain their approach.

**Q19: Are there alternative ways in which the FRC could highlight best practice in reporting other than the tiering exercise as it was undertaken in 2016?**

- 4.10 Responses to the initial consultation showed strong support for the tiering process, with most respondents noting that they would like to see this continue. Many respondents noted that they had found the process useful, either internally in further embedding good stewardship, or as a tool for assessing asset managers. However, there are concerns that the tiering process had been devalued by having too many signatories in the top tier.
- 4.11 A number of suggestions were made of ways the FRC could highlight best practice. Many felt that the Stewardship Code would benefit from further oversight, via an annual monitoring survey, a review of signatories through annual stewardship reports, or through a mechanism akin to the FRC Financial Reporting Lab.
- 4.12 There was a broad consensus that focusing on the quality of stewardship activities and outcomes would be more useful than commenting on the quality of description of policy. Those who had been supportive of moving to a best practice format, felt that highlighting best practice in reporting would make oversight and monitoring easier and more effective.

**Q20: Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?**

- 4.13 Some respondents felt strongly that it was not appropriate to mirror the UK Corporate Governance Code, again noting that this risks a box ticking, compliance approach and that maintaining flexibility is critical. However, the majority of respondents favoured introducing at least some mirrored elements. There was support for strengthening the definition of the purpose of stewardship and for the inclusion of issues such as culture and diversity, workforce matters and other elements of environmental, social and governance (ESG) matters within the Stewardship Code. Many respondents were also in favour of including a similar duty for investors as exists under section 172 of the Companies Act for directors. There was support for signatories to report on how they had considered a wide range of stakeholders in their own organisations, their investment process and the companies in which they invest.

**Q21: How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?**

- 4.14 There were mixed views on how the Stewardship Code could better encourage investors to support the long-term success of investee companies. Some felt that the Stewardship Code was not an appropriate mechanism to determine the role investors can play in supporting long-term business success. There was also support for embedding long-termism throughout the whole stewardship code, with some respondents believing that signatories should demonstrate how their approach to stewardship improves sustainable company performance.
- 4.15 A variety of specific ideas to build a company's long-term success were put forward by respondents. These included explicitly referencing bond holders to encourage a wider group of investors to engage in stewardship, reporting on timescales of investments (including a principle dedicated to responsible investment), requiring more reporting on ESG integration and how managers are monitoring and engaging with investee companies.

**Q22: Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?**

- 4.16 The majority of respondents agreed that the effective consideration of long term issues, including ESG matters, and assessment of a company's impact on its wider stakeholders, is a critical part of good stewardship. Views were mixed on how best to integrate these ideas more explicitly in the Code, particularly if they comprise a core part of the overall investment process.
- 4.17 While many respondents were supportive of specific references to ESG and the need to be more explicit about the need for investors to hold company directors to account for their duties, many also felt that a prescribed list of ESG issues would be unhelpful, preferring to encourage engagement on the issues which the investor considers material. There was a broad preference for the Stewardship Code to encourage a focus on material long-term issues, or to require a description of how investments and stewardship approaches align with clients' long-term best interests, as a useful way of encouraging signatories to consider ESG issues, without being too prescriptive.

**Q23: How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?**

- 4.18 While some respondents were concerned that reporting on engagement activities and outcomes presents a significant challenge, mainly due to the need for context, the time engagements can take, the variety of investment approaches and a lack of clear measures, the majority were in favour of enhanced reporting. Many asset owner respondents noted that the current reporting on policies is not as helpful to them in their selection and monitoring over asset managers as more fulsome reporting focusing on activities and outcomes would be. Respondents were broadly supportive of some kind of periodic reporting, and many noted existing frameworks that they feel work well, including the UN PRI, the Investment Association Stewardship Reporting Framework and guidance issued by the National Association of Pension Funds (now the Pensions and Lifetime Savings Association).

**Q24: How could the Stewardship Code take account of some investors' wider views of responsible investment?**

- 4.19 Views were mixed regarding how the Stewardship Code might reflect some investors' views of responsible investment. Many respondents were concerned that by prescribing responsible investment, the Stewardship Code would become too prescriptive and fail to recognise the variety of investment approaches across the market. They felt it was more appropriate to ensure that the Stewardship Code is based on high level principles that allow the flexibility for signatories to report their own approaches. Others felt that it would be useful for signatories to discuss the nature of their responsible investment approach if they have one.
- 4.20 There was broad agreement that including an increased range of asset classes in the Stewardship Code would be helpful, with fixed income assets being the most frequently cited as appropriate for inclusion. Many respondents encouraged any revisions to the code to be cognisant of other global developments, including the outputs of the EU High Level Expert Group on Sustainable Finance.

**Q25: Are there elements of international stewardship codes that should be included in the Stewardship Code?**

- 4.21 Respondents generally acknowledged the Stewardship Code's leading position internationally. While they noted that many international codes use the UK Code as a starting point, there were some specific items that were cited as potentially useful to include in a revised UK code. Highlighted items included ESG requirements in Japan, Australia and elsewhere, criteria on stock lending in the Dutch code and the Japanese code requirement to ensure investors are using resources of the right calibre for their engagement. Many respondents also acknowledged the ICGN's Global Stewardship Principles as a useful guide.

**Q26: What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?**

- 4.22 Many respondents do not believe that the current external assurance process is helpful, noting it had added little value to their processes or their clients. Many also noted that their stewardship activities are already subject to internal audit which has a broader scope than the current focus of external code assurance. Other respondents commented that the provision of non-audit assurance has evolved significantly since the last version of the Code and that it could be possible to develop external assurance that is more useful. While some respondents are in favour of assurance to validate the assertions made by signatories on a periodic basis rather than annually, there was broad consensus that it is not helpful to mandate external assurance.

**Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?**

- 4.23 While many asset owners strongly support the code asking asset managers to disclose their approach to voting in pooled funds, the majority of asset managers were not supportive of making this a requirement of the Code. Many concerns about the practicality of offering split voting were raised, as well as the benefits of pooled investments in terms of lowering costs. However, it was also acknowledged that this is a market issue, that needs to be resolved on a competitive basis between various asset managers and with their clients.

**Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?**

4.24 There was broad agreement that board and pipeline diversity is an important part of investor engagement, and that mirroring the requirements of the UK Corporate Governance Code would be helpful. However, many respondents raised significant concerns about being overly prescriptive and creating box ticking behaviour. Some respondents were very clear that it would be unhelpful to focus on particular parts of the UK Corporate Governance Code and would prefer an approach that encourages investors to consider all aspects of the corporate governance code and material issues related to the companies they are investing in.

**Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting?**

4.25 The majority of respondents favour a materiality-based approach rather than a checklist of specific issues, in this case, climate change. It is notable that there was significant support for investors to pay much more attention to environmental issues, and for the reporting requirements as set out by the Taskforce for Climate-Related Financial Disclosures. Respondents who were against mandating a climate change consideration were generally accepting that it may occur as a material issue on which they engage with investee companies.

**Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?**

4.26 There was clear support from an overwhelming majority of respondents for signatories giving a definition of the purpose of stewardship with respect to the role of their organisation. There were very few concerns raised with this suggestion, however those that were raised mainly focused on the risk of these statements adding little value or becoming boiler-plate.

**Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?**

4.27 While respondents saw no need to replicate the entire stewardship statement at the fund level, they were broadly supportive of setting out fund specific approaches on a voluntary basis or through fund level regulations rather than the Stewardship Code. Many respondents feel that this would add transparency and be useful to asset owners in understanding the different purposes and approaches of various funds. However, others raised concerns that this would lead to excessive and costly reporting burdens on asset managers and would lead to boiler-plate disclosure.

## 5 THE STRUCTURE OF THE 2016 CODE COMPARED TO 2018 VERSION

The Principles and Provisions in the current Code are detailed in the left hand column. The right hand column shows where they have been incorporated into the new Code, the *Guidance on Board Effectiveness* (the Guidance) or deleted.

2016 CODE	2018 CODE
<p><i>The Role of the Board</i> Main Principle A.1 Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.</p>	Principle A
<p>Supporting Principles A.1 The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed.</p> <p>The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.</p> <p>All directors must act in what they consider to be the best interests of the company, consistent with their statutory duties.</p>	<p>Incorporated into Principles A &amp; C</p> <p>Incorporated into Principles B &amp; C</p> <p>Incorporated into Principle B</p>
<p>Provision A.1.1 The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision.</p> <p>The annual report should include a statement of how the board operates, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management.</p>	<p>Guidance (paragraph 28)</p> <p>Guidance (paragraph 63)</p>
<p>Provision A.1.2 The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors.</p>	Incorporated into Provision 14
<p>Provision A.1.3 The company should arrange appropriate insurance cover in respect of legal action against its directors.</p>	Deleted

2016 CODE	2018 CODE
<p><i>Division of Responsibilities</i> Main Principle A.2 There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.</p>	<p>Incorporated into Principle G</p>
<p>Provision A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.</p>	<p>Incorporated into Provision 9</p>
<p><i>The Chairman</i> Main Principle A.3 The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.</p>	<p>Incorporated into Principle F</p>
<p>Supporting Principles A.3 The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues.  The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors.  The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.</p>	<p>Guidance (paragraph 61)  Incorporated into Principle F  Incorporated into Principle F and Provision 3 respectively</p>
<p>Provision A.3.1 The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company.  If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.</p>	<p>Incorporated into Provisions 9  Incorporated into Provision 9</p>
<p><i>Non-Executive Directors</i> Main Principle A.4 As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.</p>	<p>Incorporated into Principle H</p>

2016 CODE	2018 CODE
<p>Supporting Principle A.4 Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.</p> <p>They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible.</p> <p>They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.</p>	<p>Incorporated into Provision 13</p> <p>Incorporated into Principles M &amp; N</p> <p>Incorporated into Provision 13 (also within remuneration and nomination committee responsibilities)</p>
<p>Provision A.4.1 The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary.</p> <p>The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.</p>	<p>Incorporated into Provision 12</p> <p>Incorporated into Provision 12 and Guidance (paragraph 67)</p>
<p>Provision A.4.2 The chairman should hold meetings with the non-executive directors without the executives present.</p> <p>Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate.</p>	<p>Incorporated into Provision 13</p> <p>Incorporated into Provision 12</p>
<p>Provision A.4.3 Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.</p>	<p>Incorporated into Provision 8</p>
<p><i>The Composition of the Board</i> Main Principle B.1 The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.</p>	<p>Incorporated into Principle K</p>

2016 CODE	2018 CODE
<p>Supporting Principles B.1</p> <p>The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.</p> <p>The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.</p> <p>The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.</p> <p>No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.</p>	<p>Deleted</p> <p>Incorporated into Principle G</p> <p>Guidance (paragraph 63)</p> <p>Guidance (paragraph 64)</p>
<p>Provision B.1.1</p> <p>The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:</p> <ul style="list-style-type: none"> <li>• has been an employee of the company or group within the last five years;</li> <li>• has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;</li> <li>• has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;</li> </ul>	<p>Incorporated into Provision 10</p>

2016 CODE	2018 CODE
<p>Provision B.1.1 [contd.]</p> <ul style="list-style-type: none"> <li>• has close family ties with any of the company’s advisers, directors or senior employees;</li> <li>• holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;</li> <li>• represents a significant shareholder; or</li> <li>• has served on the board for more than nine years from the date of their first election.</li> </ul>	
<p>Provision B.1.2</p> <p>Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.</p>	<p>Incorporated into Provision 11 (smaller companies exemption removed)</p>
<p><i>Appointments to the Board</i></p> <p>Main Principle B.2</p> <p>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.</p>	<p>Incorporated into Principle J</p>
<p>Supporting Principles B.2</p> <p>The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.</p> <p>The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.</p>	<p>Incorporated into Principle J</p> <p>Incorporated into Principle J &amp; Provision 17</p>
<p>Provision B.2.1</p> <p>There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship.</p> <p>The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.</p>	<p>Incorporated into Provision 17</p> <p>Guidance (paragraph 63)</p>

2016 CODE	2018 CODE
<p>Provision B.2.2 The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.</p>	<p>Guidance (paragraph 92)</p>
<p>Provision B.2.3 Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director.</p> <p>Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.</p>	<p>Deleted</p> <p>Deleted</p>
<p>Provision B.2.4 A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.</p> <p>An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.</p>	<p>Incorporated into Provision 23</p> <p>Incorporated into Provision 20</p>
<p><i>Commitment</i> Main Principle B.3 All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.</p>	<p>Incorporated into Provision 15</p>
<p>Provision B.3.1 For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.</p>	<p>Guidance (paragraph 96)</p>

2016 CODE	2018 CODE
<p>Provision B.3.2 The terms and conditions of appointment of non-executive directors should be made available for inspection. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.</p>	<p>Guidance (paragraphs 95-96)</p>
<p>Provision B.3.3 The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.</p>	<p>Incorporated into Provision 15</p>
<p><i>Development</i> Main Principle B.4 All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.</p>	<p>Guidance (paragraphs 61, 75-76 &amp; 81)</p>
<p>Supporting Principles B.4 The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.  To function effectively all directors need appropriate knowledge of the company and access to its operations and staff.</p>	<p>Partly incorporated into Provision 22, otherwise in Guidance (paragraphs 61, 73 and 82)</p>
<p>Provision B.4.1 The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.</p>	<p>Guidance (paragraphs 61 &amp; 73) but see Provision 3 on shareholder engagement</p>
<p>Provision B.4.2 The chairman should regularly review and agree with each director their training and development needs.</p>	<p>Partly incorporated into Provision 22, otherwise in Guidance (paragraph 81)</p>
<p><i>Information and Support</i> Main Principle B.5 The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.</p>	<p>Partly incorporated into Principle I, otherwise in Guidance (paragraph 30)</p>

2016 CODE	2018 CODE
<p>Supporting Principles B.5 The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.</p> <p>Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.</p> <p>The company secretary should be responsible for advising the board through the chairman on all governance matters.</p>	<p>Partly incorporated into Principle F, otherwise in Guidance (paragraphs 61, 73 and 81)</p>
<p>Provision B.5.1 The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.</p>	<p>Guidance (paragraph 83)</p>
<p>Provision B.5.2 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.</p>	<p>Partly incorporated into Provision 16, otherwise in Guidance (paragraph 80 &amp; 85)</p>
<p><i>Evaluation</i> Main Principle B.6 The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.</p>	<p>Incorporated into Principle L, Provision 21 and Guidance (paragraph 106)</p>
<p>Supporting Principles B.6 Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness.</p> <p>The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.</p>	<p>Incorporated into Principles K and L plus Guidance (paragraph 109)</p> <p>Incorporated into Provision 22</p>

2016 CODE	2018 CODE
<p>Supporting Principles B.6 [contd.] Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).</p>	<p>Incorporated into Principle L</p>
<p>Provision B.6.1 The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.</p>	<p>Incorporated into Provision 23</p>
<p>Provision B.6.2 Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.</p>	<p>Incorporated into Provision 21</p>
<p>Provision B.6.3 The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.</p>	<p>Incorporated into Provision 12</p>
<p><i>Re-election</i> Main Principle B.7 All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.</p>	<p>Incorporated into Principle K &amp; Provision 18</p>
<p>Provision B.7.1 All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election.</p> <p>The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.</p>	<p>Incorporated into Provision 18, but now covers all directors</p> <p>Partly incorporated into Provision 18</p>
<p>Provision B.7.2 The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.</p>	<p>Incorporated into Provision 18</p>

2016 CODE	2018 CODE
<p><i>Financial and Business Reporting</i> Main Principle C.1 The board should present a fair, balanced and understandable assessment of the company's position and prospects.</p>	<p>Incorporated into Principle N</p>
<p>Supporting Principles C.1 The board's responsibility to present a fair, balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.</p> <p>The board should establish arrangements that will enable it to ensure that the information presented is fair, balanced and understandable.</p>	<p>Incorporated into footnote to Principle M</p>
<p>Provision C.1.1 The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities.</p>	<p>Incorporated into Provision 27</p>
<p>Provision C.1.2 The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.</p>	<p>Incorporated into Provision 1</p>
<p>Provision C.1.3 In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.</p>	<p>Incorporated into Provision 30</p>
<p><i>Risk Management and Internal Control</i> Main Principle C.2 The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.</p>	<p>Incorporated into Principle O</p>

2016 CODE	2018 CODE
<p>Provision C.2.1 The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.</p>	<p>Incorporated into Provision 28</p>
<p>Provision C.2.2 Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.</p>	<p>Incorporated into Provision 31</p>
<p>Provision C.2.3 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, including financial, operational and compliance controls.</p>	<p>Incorporated into Provision 29</p>
<p>Audit Committee and Auditors Main Principle C.3 The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.</p>	<p>Incorporated into Principle M &amp; Provision 25</p>
<p>Provision C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. The audit committee as a whole shall have competence relevant to the sector in which the company operates.</p>	<p>Incorporated into Provision 24</p>

2016 CODE	2018 CODE
<p>Provision C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:</p> <ul style="list-style-type: none"> <li>• to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;</li> <li>• to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;</li> <li>• to monitor and review the effectiveness of the company's internal audit function;</li> <li>• to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;</li> <li>• to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;</li> <li>• to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and</li> <li>• to report to the board on how it has discharged its responsibilities.</li> </ul>	<p>Incorporated into Provision 25</p>
<p>Provision C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.</p>	<p>Guidance (paragraph 63)</p>

2016 CODE	2018 CODE
<p>Provision C.3.4 Where requested by the board, the audit committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.</p>	<p>Incorporated into Principle M &amp; Provision 27 (also see the Guidance on Audit Committees)</p>
<p>Provision C.3.5 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.</p>	<p>Incorporated into Provision 6</p>
<p>Provision C.3.6 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.</p>	<p>Incorporated into Provisions 25 &amp; 26</p>
<p>Provision C.3.7 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.</p>	<p>Incorporated into Provision 25 &amp; 26</p>
<p>Provision C.3.8 A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:</p> <ul style="list-style-type: none"> <li>• the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;</li> </ul>	<p>Incorporated into Provision 26</p>

2016 CODE	2018 CODE
<p>Provision C.3.8 [contd.]</p> <ul style="list-style-type: none"> <li>• an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm when a tender was last conducted and advance notice of any retendering plans; and</li> <li>• if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.</li> </ul>	
<p><i>The Level &amp; Components of Remuneration</i> Main Principle D.1 Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.</p>	Incorporated into Principle P
<p>Supporting Principles D.1 The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in corporate and individual performance, and should avoid paying more than is necessary.</p> <p>They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.</p>	Deleted  Incorporated into Provision 33
<p>Provision D.1.1 In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code. Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.</p>	Incorporated into Provision 37
<p>Provision D.1.2 Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.</p>	Deleted

2016 CODE	2018 CODE
<p>Provision D.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements.</p> <p>If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in Provision B.1.1).</p>	<p>Incorporated into Provision 34</p>
<p>Provision D.1.4 The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.</p>	<p>Provision 38</p>
<p>Provision D.1.5 Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.</p>	<p>Provision 39</p>
<p><i>Procedure</i> Main Principle D.2 There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.</p>	<p>Incorporated into Principle Q</p>
<p>Supporting Principles D.2 The remuneration committee should take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management, or consulting the chief executive about its proposals. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration.</p> <p>The chairman of the board should ensure that the committee chairman maintains contact as required with its principal shareholders about remuneration.</p>	<p>Incorporated into Provision 35</p> <p>Incorporated into Provision 3</p>

2016 CODE	2018 CODE
<p>Provision D.2.1 The board should establish a remuneration committee of at least three, or in the case of smaller companies' two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, they should be identified in the annual report and a statement made as to whether they have any other connection with the company.</p>	<p>Incorporated into Provision 32</p> <p>Incorporated into Provision 35</p>
<p>Provision D.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management.</p> <p>The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.</p>	<p>Incorporated into Provision 33</p> <p>Footnoted in Code</p>
<p>Provision D.2.3 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.</p>	<p>Provision 34</p>
<p>Provision D.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.</p>	<p>Deleted</p>
<p><i>Dialogue with Shareholders</i> Main Principle E.1 There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.</p>	<p>Incorporated into Principle D &amp; Provision 3</p>

2016 CODE	2018 CODE
<p>Supporting Principles E.1 Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns.</p> <p>The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.</p>	<p>Guidance (paragraph 61)</p> <p>Incorporated into Provision 3 and Guidance (paragraph 35)</p>
<p>Provision E.1.1 The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.</p>	<p>Incorporated into Provisions 3 &amp; 12</p>
<p>Provision E.1.2 The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.</p>	<p>Incorporated into Principle D &amp; Provision 3 and Guidance (paragraph 35)</p>
<p><i>Constructive Use of General Meetings</i> Main Principle E.2 The board should use general meetings to communicate with investors and to encourage their participation.</p>	<p>Incorporated into Provision 3 and Guidance (paragraph 65)</p>
<p>Provision E.2.1 At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.</p>	<p>Deleted</p>





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