

## Edis-Bates Associates

Working with Boards and Company Secretaries

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28 February 2018

Dear Sirs

### Response to the FRC's Consultation on the New UK Corporate Governance Code

Thank you for the opportunity to respond to this consultation.

Our consultancy, Edis-Bates Associates Ltd, advises listed PLCs on corporate governance and board issues. We also run seminars for company secretaries on regulatory matters affecting listed PLCs, involving external expert speakers. In addition, we facilitate external board performance evaluations for FTSE 100, FTSE 250 and smaller listed PLCs. Before setting up Edis-Bates Associates in 1997, I worked as company secretary of three listed PLCs. It is against this background that I have approached the consultation issued last December.

I have the following comments on the consultation paper. We have been selective in the questions we have responded to, focusing only on those where we have a view.

#### Part 1: General Observations

- 1. Straw Poll Results:** Our firm conducted a straw poll in the week commencing 5 February 2018 amongst company secretaries. We received 63 responses, mainly from company secretaries within the FTSE 350. I have attached two files: first, a set of slides showing the responses to the specific questions we asked; second, a set of unattributed comments made by those who participated (this also includes the full questions we asked).
- 2. Timing of the Consultation:** A majority of larger companies have 31 December year ends. The persons responsible within those companies for the details of corporate governance are the company secretaries. Many company secretaries are incredibly busy at this time of year in the preparation of annual reports and related work. Asking companies to respond to a consultation with a cut-off date of 28 February is not conducive to full participation. A better time would be after the AGM season.

## **Part 2: Responses to the Questions raised in the Consultation Paper**

### **Question 1: The Code Application Date**

There will be a significant amount of work involved in complying with the new Code and Guidance. For many companies, this will be concentrated in a 6 month window between the publication of the final Code in June 2018 and the end of the financial year (31 December for the majority of companies). This is mainly because companies will want to be seen to apply/comply fully for the whole of 2019. Much of this work will fall upon the company secretary. Perhaps the proxy advisors should be encouraged by the FRC to 'go easy' on companies that do not have all their new processes in place by 1 January 2019.

### **Question 2: The Revised Guidance**

There is concern amongst companies that proxy advisors will see the Guidance as an extension of the Code and will use the Guidance as a checklist of items which the proxy advisors will consider when reviewing companies' annual reports and governance practices. For example, the question might be asked whether a board (or its remuneration committee) has addressed the 60 questions set out in the Guidance. It is clear from our straw poll results that few boards will.

The FRC is encouraged to state categorically that the Guidance should not be used as the basis for a box-ticking exercise. In this regard, the prospect of introducing an effective code of practice for proxy advisors is to be welcomed.

### **Question 3: Method for gathering in Workforce Views**

As can be seen from the straw poll results, hardly any companies plan to go down the route of arranging for a director appointed (or elected?) by the workforce, although we are aware that this has happened in one or two instances.

We believe that setting up a formal workforce advisory panel would be the best option for larger companies, perhaps for the FTSE 350. We do not believe that smaller companies outside the FTSE 350 should feel obliged to put in place such measures.

We are aware that some companies are looking at feeding the views from this panel through to a nominated non-executive, which seems a sensible solution.

The concern we have is that most companies will go for the easiest option of simply nominating a non-executive to represent the views of the workforce around the board table. There is a risk that the spirit of this new initiative to raise workforce views will be watered down unless some fuller mechanism is put in place to elicit workers' views.

I wonder if the word 'normally' in Provision 3 might be amended to clarify that the key thing is to obtain these views, rather than pushing three particular methods? It should be made clearer that companies should be entitled to choose their own method, provided it is effective.

### **Question 6: Board Evaluations**

This question covers exemptions for smaller companies, but our comments here relate to board performance evaluations only. First, we disclose our interest in that our firm has for many years carried out external board performance evaluations for FTSE 350 companies.

This experience has provided us with some insight into the value received by those companies. We believe, perhaps not surprisingly, that it would be in the interests of companies outside the FTSE 350 to have an external evaluation conducted every three years. The results from our straw poll appear to support this. In our view, it is very rare that boards do not make good use of the findings of these reviews, and the company benefits as a result.

Since smaller companies have less financial resource, it will be tempting for them to put in place the most basic of evaluation processes. This would possibly be an online version (in which the directors type in their own responses and limited comments) – and may not include any 1-2-1 interviews with a (potentially challenging) external facilitator. It is our view that a non-rigorous evaluation will cost the company money and produce very little benefit. In order for these smaller companies to benefit significantly from these external evaluations, it is important that they are carried out 'rigorously', rather than simply going through the motions. We know from our due diligence that internal evaluations often struggle to meet the current requirement for rigour. We believe that it would be helpful to companies to emphasise the need for rigour, possibly with examples of what is required. It should still be possible for smaller companies to conduct effective evaluations at a proportionate cost.

Provision 21 contains a requirement to disclose the connections between an external facilitator and individual directors. The same applies to remuneration consultants (Provision 35). It would be helpful to have some guidance on what connections need to be disclosed.

#### **Question 7 & 8: Nine Year Rule and Independence**

We would agree that nine years is a suitable period for both chairs and other non-executives, provided that this was on a comply or explain basis. There are occasionally circumstances when it might be appropriate to allow the chair (or a non-executive) to remain in office for longer than nine years, but it should be incumbent on the board to explain fully the circumstances. And the individual should be clearly described as non-independent at that point. We would encourage the FRC to state that this should be a truly exceptional set of circumstances and not a manufactured rationale for holding onto the role.

We are a little troubled by the fact that the independence of the chair is covered in both a principle and a provision. The key thing is that the comply or explain rule applies.

We strongly agree with the change in the introduction to Provision 15. Directors should not be tempted to state that a non-executive director is independent when he clearly is not!

#### **Other Points on the Corporate Governance Code**

**Principle J** covers succession planning. In conducting board evaluations, we have often been told that an effective succession plan is in place, only to find that no such plan has been reduced to writing and that different directors have different views of what the plan is. Would it not be helpful for boards to be asked to put the plan in writing? This may be one of those occasions when a limited circulation list is required.

**Provision 1** talks of a disclosure about how the company's governance contributes to the delivery of the strategy. I wonder how many people really believe that it does?

**Provision 9** provides that the responsibilities of certain key players on the board should be set out in writing. We would propose that the responsibilities of the company secretary be added to this list. In practice, this is the key person who deals with the governance of the board – dealing with all the relevant issues and supporting the chairman - and it would be helpful for the board to formally acknowledge this specialist role. When there are difficult

issues to address (for example, whether a non-executive is independent) this would enable the objective company secretary to play a greater advisory role than is often the case.

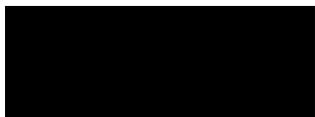
**Provision 23** refers to the Nomination Committee. We support these changes and, more broadly, the need to ensure that this committee operates more rigorously and is taken more seriously.

**Provision 40** requires 'clarity' and 'simplicity' in incentive scheme rules. This is not my area of expertise, but (given the responses to our straw poll) I suspect that companies have no plans to rewrite the rules of their LTIPs and other incentive plans to make them more understandable. In my career I have invested a good deal of time explaining such plans to senior executives who still ask questions demonstrating that their understanding is far from clear. There is a risk here that the initiative to try to make such plans understandable to readers of the annual report is falling on deaf ears.

### **The UK Stewardship Code**

We have no comments on this code, except that we believe that there ought to be sanctions to ensure compliance by the owners of their investee companies. We understand that it often still remains difficult to engage with these owners, who rely so heavily upon their proxy advisors.

Yours faithfully



Jon Edis-Bates  
Director

**The New UK Corporate  
Governance Code**

**Responses to  
Straw Poll  
Questions**



**Jon Edis-Bates**

**21 February 2018**

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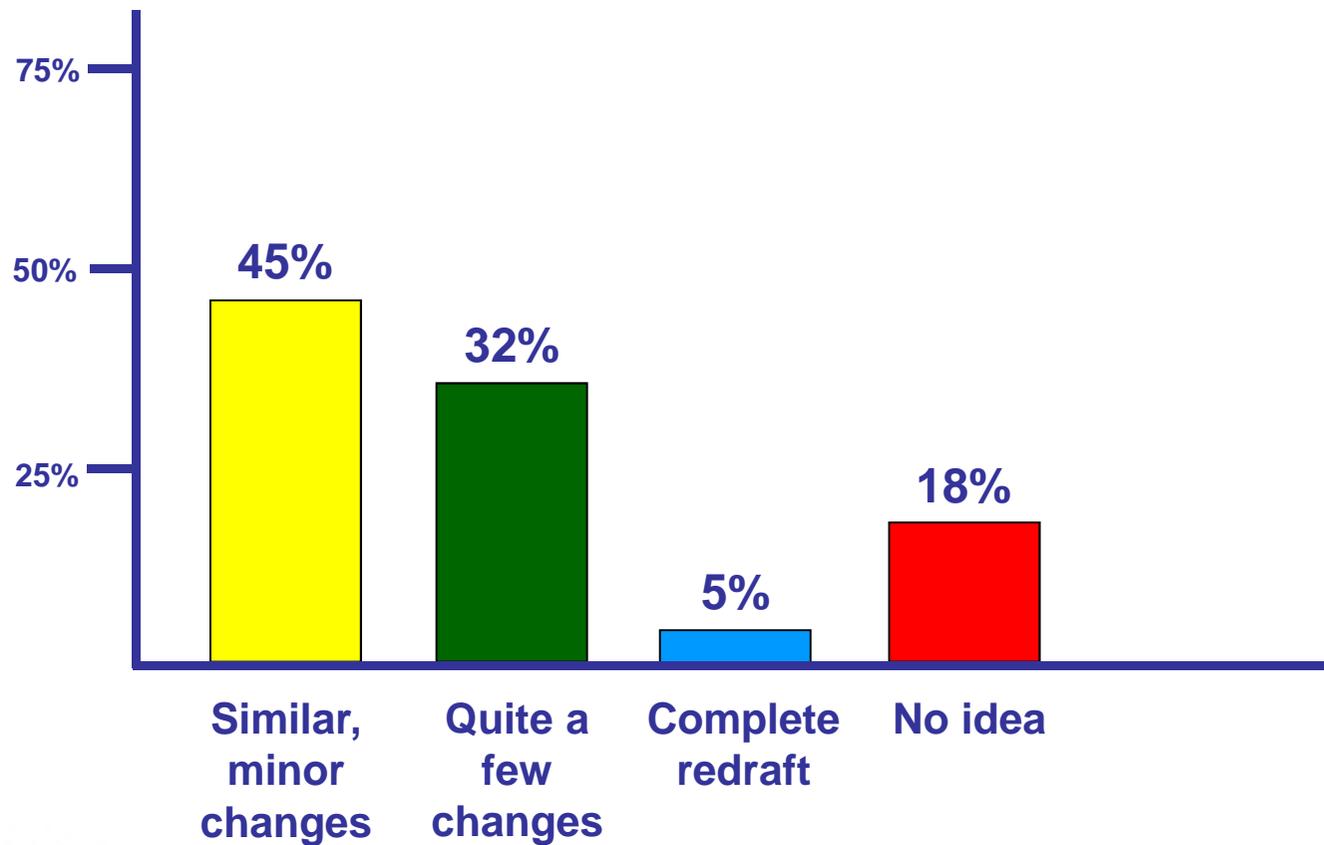


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# Disclosures under the new Code

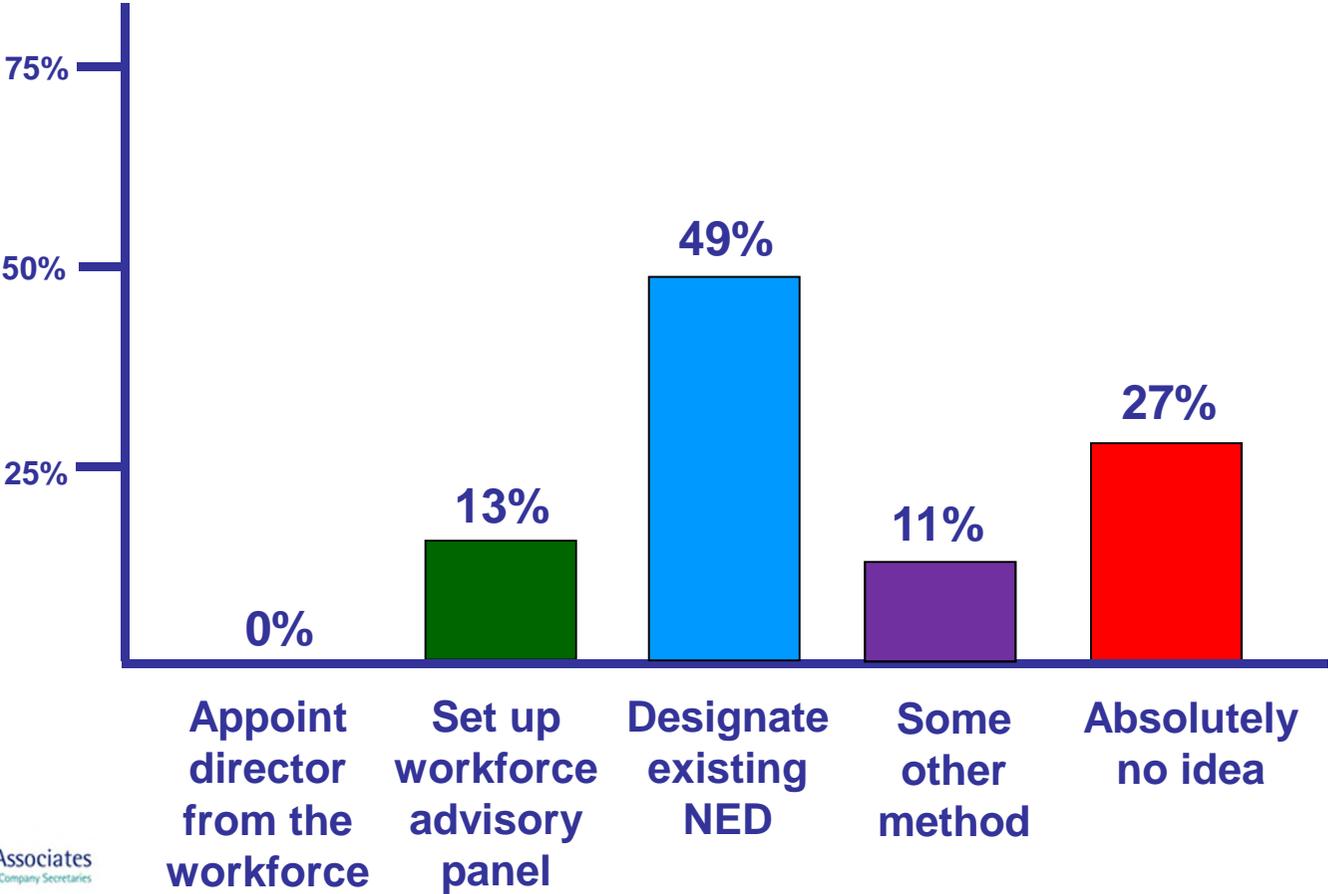
What is your current thinking on how your corporate governance disclosures will change in your first annual report under the new Code?



# Q2

## Gathering the Views of the Workforce

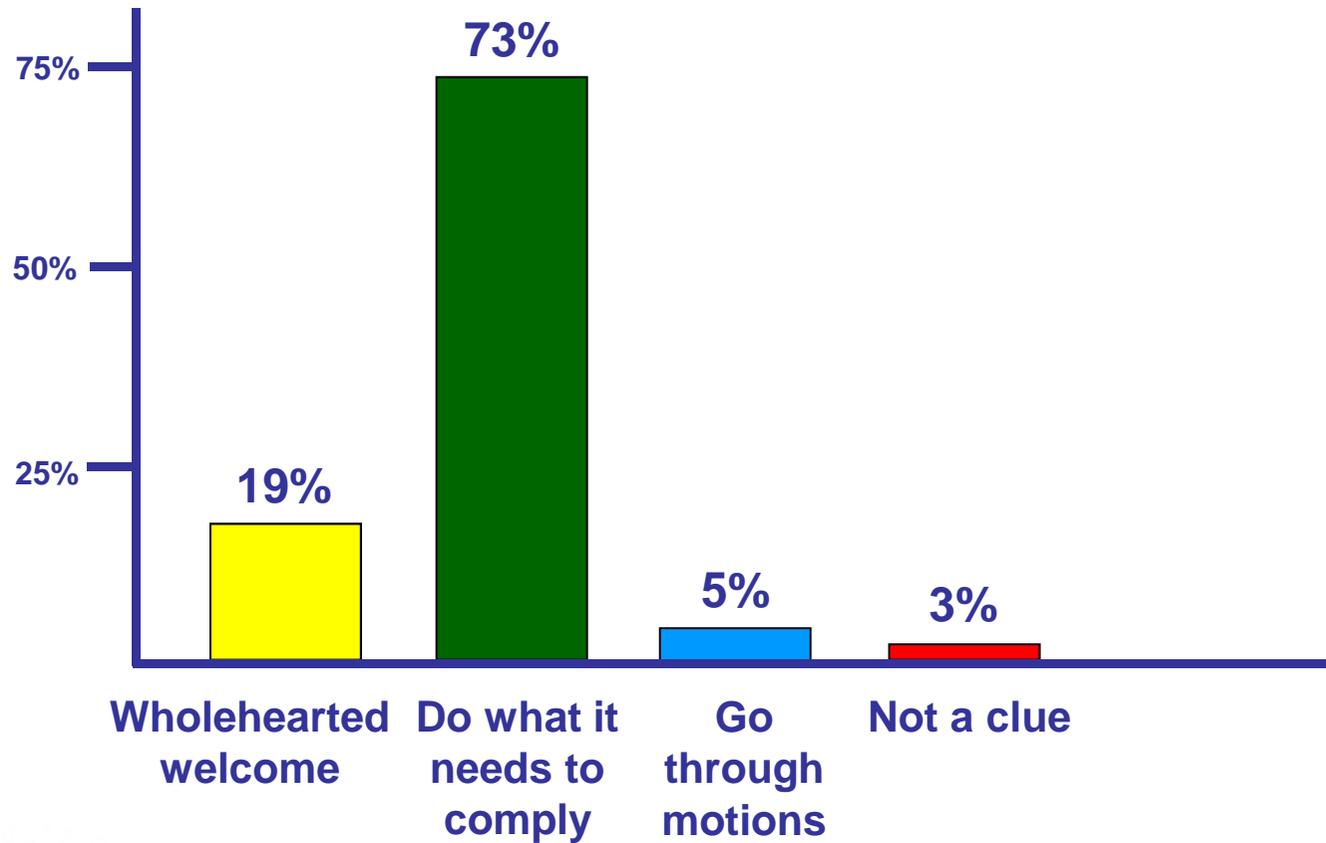
The Board will be required to establish a method for gathering views of the workforce. Which method do you believe your company will adopt?





# Board's Stance on Stakeholder Views

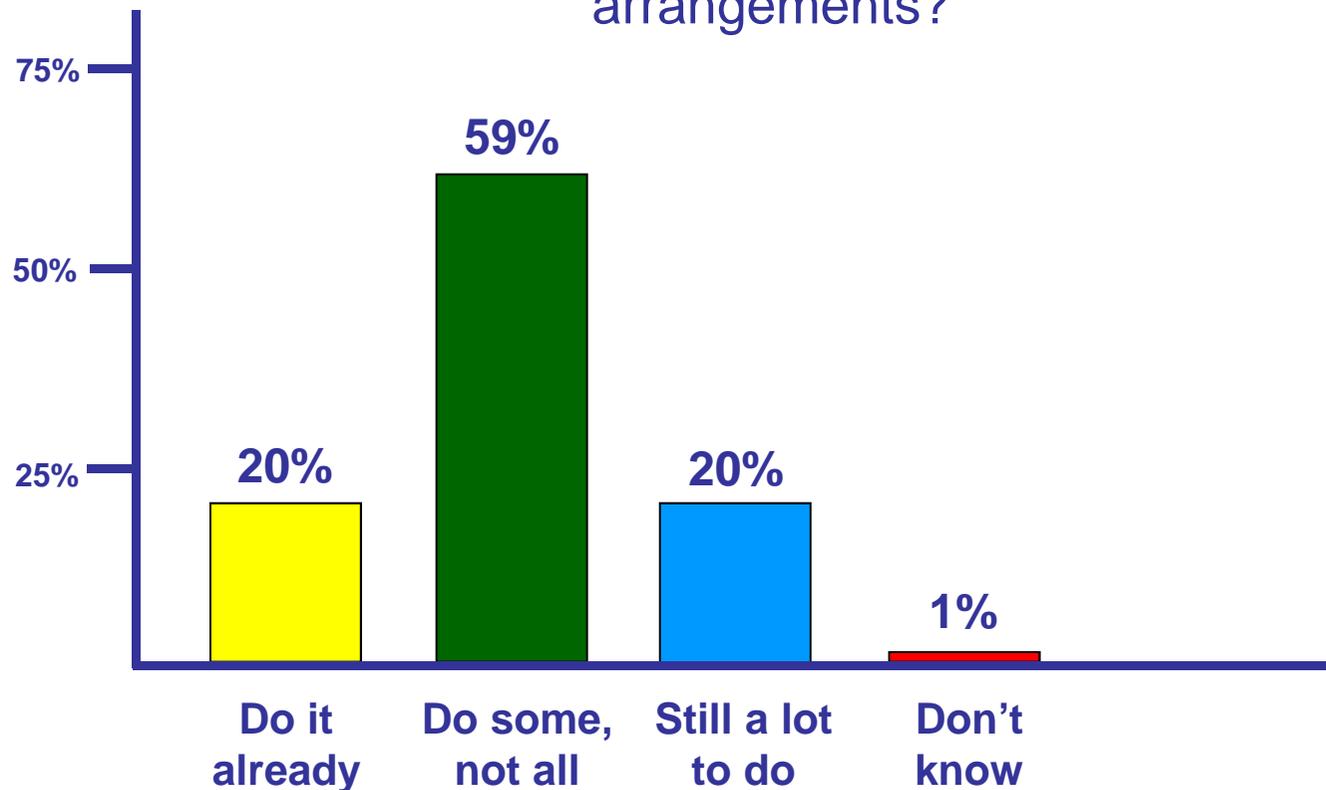
What is the board's stance about the introduction of new measures relating to wider stakeholder views?



# Q4

# Promoting Diversity

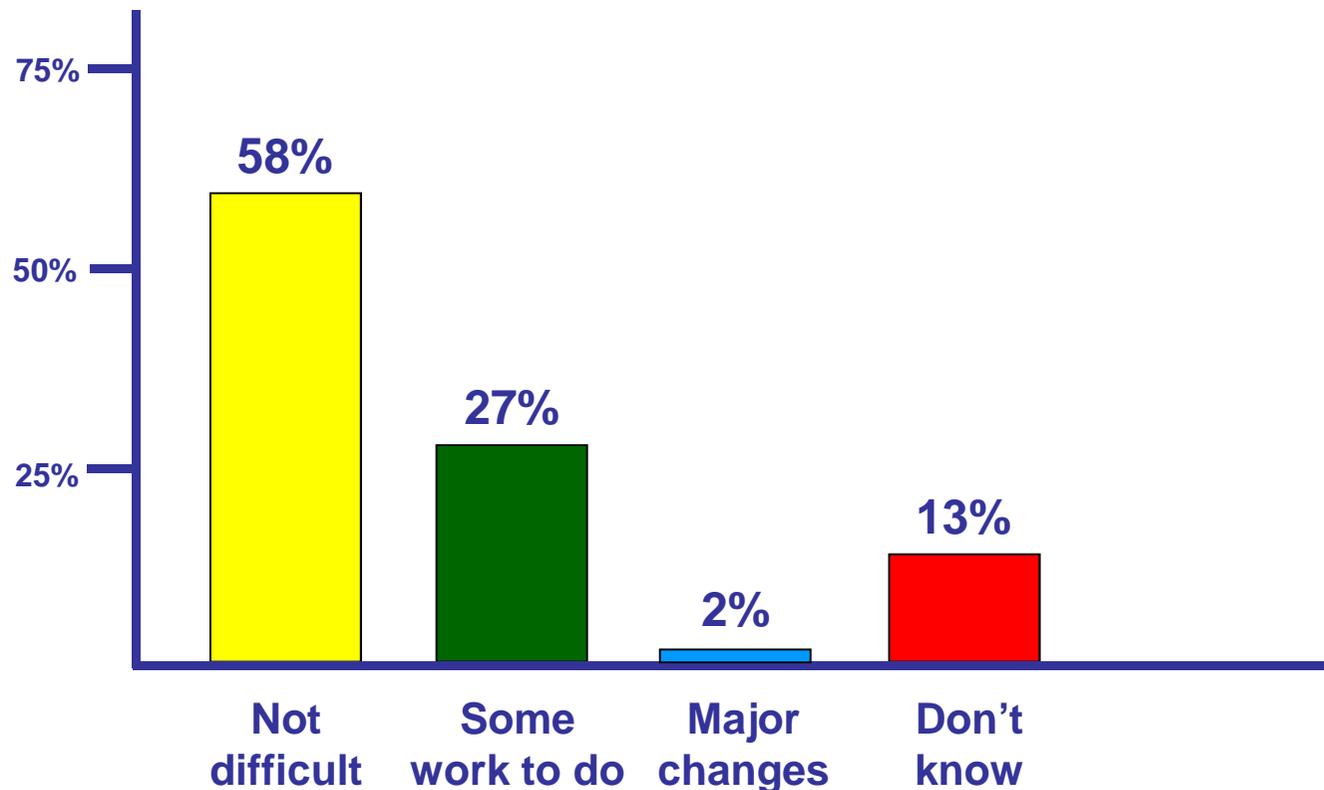
A new Principle requires board appointments and succession plans to promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths. To what extent does this reflect your company's present arrangements?



**Q5**

# Executive Remuneration Packages

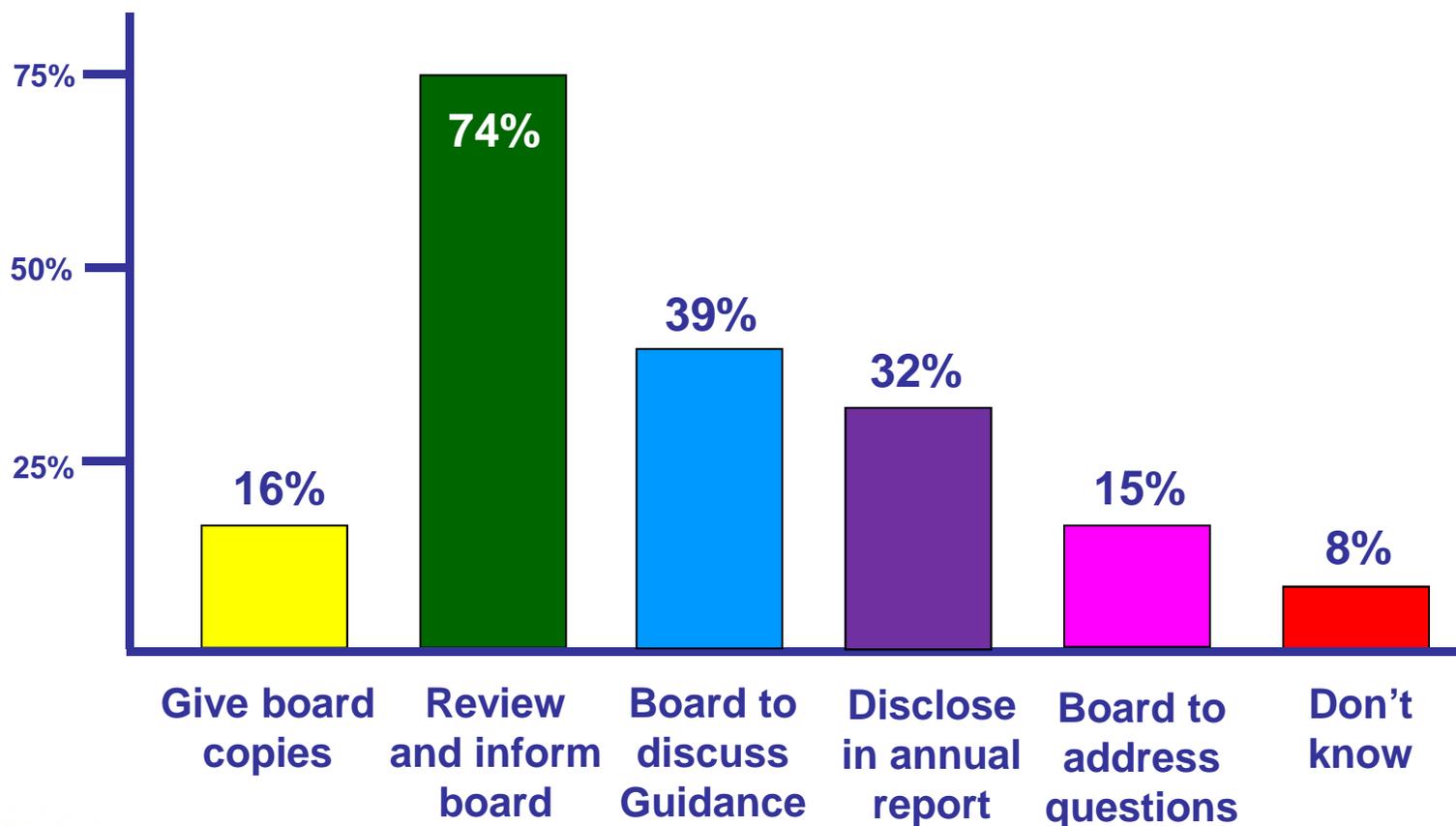
A new Provision requires Remuneration Committees to address 5 issues when setting executive remuneration policy and practices (including clarity, and simplicity). How difficult will it be to satisfy these requirements?





# Board Effectiveness Guidance

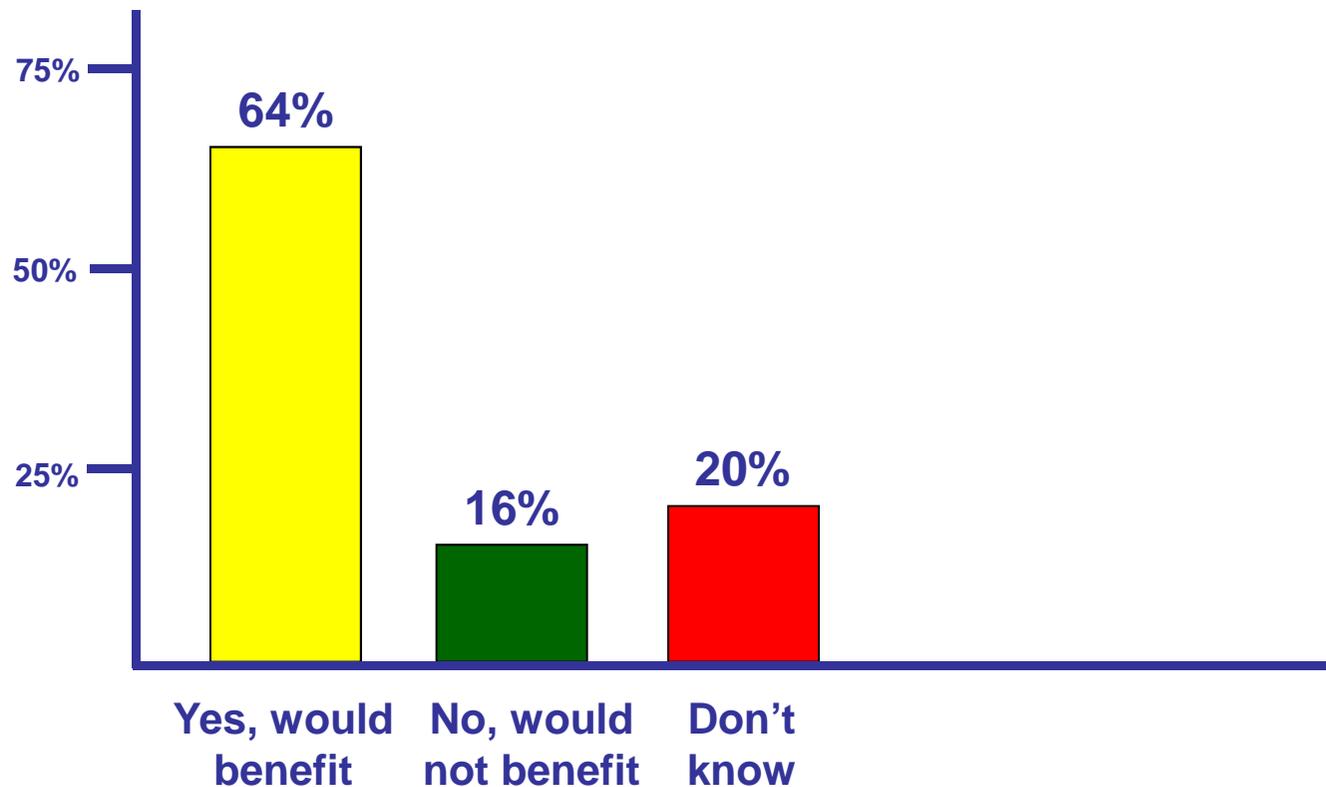
The new Guidance is intended to stimulate boards' thinking, including how they carry out their role effectively. Which actions are you most likely to take regarding the Guidance?



**Q7**

# Evaluations Outside FTSE 350

Do you believe that companies outside the FTSE 350 would benefit from an external board evaluation every 3 years? (Assuming proportionate costs)



# STRAW POLL RESPONSES

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## PART 1 - INTRODUCTION

During the week commencing 5 February, we carried out a straw poll amongst company secretaries of UK listed PLCs. As at 12 February, we had received around 63 straw poll responses (mainly from the FTSE 350), plus some further comments outside of the straw poll.

First, we asked a number of questions relating to the new UK Corporate Governance Code and the Guidance on Board Effectiveness. These questions are set out below in Part 3 of this attachment. The responses to questions 1 to 7 are set out in PowerPoint slides elsewhere in the delegate pack (see the slides for Practical Considerations).

We also asked for comments (in free form) about the acceptability of the new Code and Guidance, about the issues raised in the questions we asked, and about any other issues arising from the recent FRC consultation. The comments we received are set out in Part 2 below.

## PART 2 – COMMENTS FROM THE STRAW POLL RESPONSES

### 1. Appliance and Compliance

- Companies will have to demonstrate how they apply broad principles, compared to complying with more detailed provisions. We are concerned that this will lead to longer disclosures.

### 2. The Views of the Workforce and Wider Stakeholders

- We already have a European works council structure, so I imagine we will utilise this and appoint a non-executive to be the employee liaison for this.
- We already have an employee forum in place, so my suggestion would be to tailor this to comply with code obligations
- In our business, you literally have to gain the acceptance of the local community. This is absolutely key to our success. We have been doing this in spades for years.
- We have tried hard to engage with our investors. On those occasions when we have had a less than wholly supportive reaction from investors at the AGM (sometimes simply as a result of the inflexible stance taken by proxy advisors), we have sought to engage with our investors following the AGM vote. It has on several occasions been impossible to get the investors to engage. There ought to be more pressure applied to institutional investors to encourage/force them to engage. The Stewardship Code should require more of investors and The Investment Association should play its part more fully in enforcing this.

- The main concern from the proposals I have seen is the lack of good option on workforce representation. Otherwise, the proposals are pushing in a direction that is already understood. In some areas it is not a bad thing to force boards more explicitly to take these wider stakeholder views and issues into account. Investors (and the clients whose funds they invest) are more and more engaged with them.
- In seeking the views of our workforce, perhaps we might have a combination of a designated non-executive plus an advisory panel...not entirely sure yet.
- We would like to understand what other companies are doing about seeking wider stakeholder views. It feels like quite a mixed approach and not easy to put into practice. It is still quite unclear how much change this actually involves. There is a lot of detail in some of these proposals and I suspect that companies may find that more fundamental change is involved than we all originally thought.
- Regarding gathering the views of the workforce: We already have in place a national network of elected employee representatives. The chair of this network reports regularly to the CEO and Chairman, and periodically attends board meetings. We will review these arrangements and consider whether any changes need to be made.

### **3. Non-Executive Independence**

- The proposal to limit a chair's tenure as a director to nine years is not sensible.
- Given the changes to the performance criteria, there is a risk that this will lead to more "churn" amongst the non-executives. This is especially so in relation to the chairman, who is now required to be independent on an ongoing basis.
- The key issue in the revised code is the independence of the chair point, which isn't covered in the other straw poll questions. This would fundamentally change the nature of the chair's role – without justifying the rationale for this.
- I would be interested to know what the consensus view is about tenure of directors, including the chairman. Is nine years sufficient when choosing a chairman who may have been on the board for several years before becoming chairman? Presumably the qualities as to why he or she was chosen for the chairmanship should last a bit longer than the balance of years as a director up to the ninth year since appointment to the board?

### **4. Succession**

- I would like to know how other companies plan to deal with the succession pipeline, extending down explicitly into the company's executive, and also covering the diversity. Who will do this work?

### **5. Diversity**

- It would be interesting to know whether boards have a diversity policy for the board itself, rather than for the group as a whole.

## 6. Remuneration Committee

- Do the proposed changes affecting the remuneration committee widen the committee's remit too far by including policies for the wider workforce? How will this work in practice? It will impose an additional burden of work on committee members – and require more of their time.

## 7. Bureaucracy

- When will it stop? We seem to be losing the big picture which is that we have large complex businesses to manage in very competitive markets. What used to be value-adding non-executives with strong business experience and acumen have largely been replaced by box-ticking corporate governance non-execs with limited business experience. Just look at recent corporate failures!
- The cynic in me cannot help but say: we have more regulation today than ever – Corporate Governance Code, bribery, modern slavery, remuneration etc. Still, however, the Government and regulators think more regulation will work. But the reality is that companies will occasionally fail in capitalist markets, for example: Carillion, BHS, Enron, the banking crisis etc. More regulation will not stop this. We need to recognise that, accept it as a risk of profit and free markets and grow up. Companies need to be encouraged to make profits and provide jobs, rather than bureaucratic regulation. Politicians and regulators are deluded if they think more red tape will stop corporate failures and make the world a better or more inclusive place. It will not. The additional regulation is purely there to make politicians and regulators feel good about themselves rather than anything else.

## 8. General Comments

- If Carillion's downfall had occurred prior to the publication of this consultation, I wonder if the proposals would have been harsher?
- The proposals are an enhancement to the Code.
- We welcome the tone of the consultation and its focus on sustainable, long-term value creation, inclusion and fairness.
- Some of the proposals (e.g. gathering the views of the workforce) will be very hard to implement and will be of very limited value for a global company. These types of measures appear to be aimed at companies which are UK-centric or UK-focused. Yet many companies in the FTSE 350 are very international and some of them are not even British. At a time when the City of London needs to promote itself more strongly than ever as a home for international companies the apparent UK ('political'?) focus of the proposals is disappointing.
- The approach that will be taken will be predicated on the final outcome of the Code post consultation. In a number of instances it would be beneficial for companies to be permitted the choice as to how best each company could comply with the underlying principle. Concerns remain about the interaction of the Code as drafted and the underlying established legal principles.

- ❑ On the whole, the changes are a natural evolution of the governance agenda. However, some understanding as to how things will work in practice, and for what value, need further consideration.
- ❑ As the representative of the corporate secretary for a number of investment trust companies (who only have non-executive directors on their boards) not all aspects of the Code apply and therefore this affects the responses we have given.
- ❑ We have briefed the board every step of the way as the corporate governance reform agenda has evolved, including providing an initial assessment of the FRC's draft Code and Guidance. Our detailed review of the FRC's consultation is currently being worked on. Our initial views expressed in this straw poll may change as this year progresses and the corporate governance reform package is finalised for reporting against in our 2019 Annual Report.

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**Late item:**

My opinion is that there is too much change happening at the same time. This should be phased to allow proper consideration. Boards have to be strategic, but this is tipping too much towards regulation.

## PART 3 – THE STRAW POLL QUESTIONS

Here is the full text of the questions we asked in this straw poll:

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For the purpose of this straw poll, please assume that the new Code will broadly follow the format of the Code proposed in the current consultation.

Since we are still at consultation stage, all we are looking for in this straw poll is your own best view of your company's likely position.

### Question 1: Disclosures under the New Code

Which of the following best describes your current thinking on how your corporate governance disclosures will change in your first annual report under the new Code?

- Our disclosures will be very similar to our previous disclosures, with only minor changes to satisfy the new Code requirements.*
- We will make quite a few changes as a result of the new Code.*
- We will completely redraft our corporate governance report.*
- No idea at all at this stage.*

### Question 2: Gathering the Views of the Workforce

Provision 3 of the new Code requires the board to establish a method for gathering the views of the workforce and states three ways in which this would normally be done.

Which of the following methods do you currently believe your company is most likely to adopt?

- Appoint a new director from the workforce.*
- Establish a formal Workforce Advisory Panel (or similar).*
- Designate a non-executive director who will have special responsibility for putting forward the views of the workforce.*
- Some other method. (Please describe the proposed method in the Comments section – question 8 below.)*
- Absolutely no idea at this early stage!*

### **Question 3: The Board's Stance on Wider Stakeholder Views**

Section 172 of the Companies Act contains basic obligations to have regard (amongst other matters) to the views of employees, customers, suppliers etc. The new Code goes significantly further and includes disclosure obligations.

What is the view of your board to these new Code measures? Please choose the option below that best describes your board's most likely position going forward.

- Our board is highly receptive to wider stakeholder views and I expect it will welcome these new measures wholeheartedly.*
- Our board does listen to its different stakeholders and I expect it will do what is necessary to satisfy the new Code requirements.*
- Our board will probably go through the motions, but I believe the influence of these stakeholders' views on its decision-making will be negligible.*
- Not a clue!*

### **Question 4: Promoting Diversity**

Principle J of the new Code requires board appointments and succession plans to promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

To what extent does this reflect your company's present arrangements?

- We do all of this already.*
- We do some, but not all of this.*
- We still have a lot to do in this area.*
- Don't know.*

### **Question 5: Executive Remuneration Packages**

Provision 40 of the new Code requires remuneration committees to address five issues when determining executive director remuneration policy and practices: clarity; simplicity; predictability; proportionality and reward for individual performance; and alignment to culture.

How difficult will it be to ensure that your executive incentive plans satisfy these new requirements?

- Not difficult at all.*
- A fair bit of work will need to be done.*
- We will have to make major changes.*
- Don't know.*

### **Question 6: Reviewing the Guidance on Board Effectiveness**

The proposed new Guidance on Board Effectiveness “is intended to stimulate boards’ thinking, including how they can carry out their role most effectively.”

Which of the following actions are you most likely to take regarding the Guidance?

(Please tick all that apply.)

- We will provide directors with a copy of the final Guidance.*
- We will review our own practices against the Guidance and inform the board about the extent to which our practices align with or differ from the Guidance.*
- The final Guidance and our practices will be discussed by the board.*
- We will make some form of disclosure in our annual report about the alignment of our practices with the Guidance.*
- The board will address the questions set out in the Guidance.*
- Not a clue!*

### **Question 7: External Board Evaluations outside the FTSE 350**

Do you believe that companies outside the FTSE 350 would benefit from having an external board evaluation conducted every three years, as currently proposed in the new Code? Please assume that costs would be proportionate.

- Yes, they would probably or definitely benefit.*
- No, they would probably or definitely not benefit.*
- Don't know.*

### **Question 8: Your Comments**

We would welcome your comments about the acceptability of the new Code and Guidance, the issues raised above or any other issues arising from the recent consultation.

Your comments will not be attributed to you or your company without your express prior consent. Unattributed comments will be made available to the Financial Reporting Council before the close of the consultation.

[Insert space for 500 word text.]

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Straw Poll prepared by Edis-Bates Associates

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