FRC – Corporate Governance Code Consultation

Nest's response

About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over one million employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK, with more than £30bn in assets under management. We are operating at scale as a high-quality, low-cost pension scheme helping over 12 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

Our response

We welcome the opportunity to respond to this consultation paper issued by the Financial Reporting Council (FRC). We support the FRC's ambition to strengthen the Corporate Governance Code, particularly around making necessary revisions to reflect the responsibilities of the board and audit committee for sustainability and ESG reporting.

We agree with the objective that the board should report on the company's climate ambitions and transition planning, to provide shareholders and other stakeholders with greater transparency over long term risk. We believe strengthened regulation around governance of the board of directors will promote transparency and ensure directors' commitments and ambitions are better aligned with shareholders. The proposed amendments to the code strike the right balance between strengthening risk management/internal controls whilst not overly complicating the existing requirements. We generally agree with the FRC's proposed changes

around remuneration and support greater disclosure and reference to pay gaps within individual companies. Overall, the proposals provide positive changes to the Corporate Governance Code that supports a framework of prudent and effective controls to provide a stronger basis for reporting. However, it is important that reporting does not become duplicative and overly burdensome, to the extent that companies are put off from listing in the UK. We also support flexibility over prescription and are pleased that the FRC has maintained the Code's comply or explain approach.

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

We agree that changes to Principle D in Section 1 will encourage companies to deliver more outcomes-based reporting which is a welcome addition. Principle D clearly states that boards should focus on outcomes when reporting, which could lead to better efforts to really demonstrate impact throughout the year. Hopefully, it will ensure more effective engagement from the board regarding all governance processes and help mitigate any unavoidable risks. The annual implementation report, which will provide a summary update of how the assurance activity outlined in the audit and assurance policy is working in practice and whether any changes to the policy have been made, should be effective in helping deliver more outcomes-based reporting too. However, we suggest more guidance be given on what governance outcomes look like in practice. Governance outcomes is a broad factor, and they can vary greatly. The reporting may fall short of our expectations if companies don't reflect the meaning of the changes to principle D accurately. Our expectations would reflect detailed reporting that clearly links actions taken to direct outcomes that have either helped mitigate risks, created opportunities or led to the improvement of general governance processes. We agree with the wording at the end of principle D, 'where the board reports on departures from the Code's provisions, it should provide a clear explanation'.

Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

Yes, we are generally supportive of the proposal that the board should report on environmental and social matters including the company's climate ambitions and transition planning. It is essential for companies to demonstrate how its exposure to and management of climate change risks and opportunities form part of the board's oversight responsibilities and aligns with the proposed introduction of mandatory disclosure of corporate transition plans. Reporting on these issues will also provide stakeholders with valuable updates on the progress the company is making in achieving their longer-term climate transition targets. This could lead to more informed voting decisions at AGMs, when voting on shareholder resolutions and approving the appointment of directors. In addition, overseeing climate change and social issues are intrinsically linked with risk management and an effective board should report on how it governs its most material long-term risks. The board reporting will also give stakeholders confidence in the company's regulatory compliance in that area, jurisdictions are implementing regulation at a fast pace and ensuring board oversight will be helpful. This could

also alleviate greenwashing, where companies have to explain in a narrative way how environmental and social issues are integrated into their strategy. However, we are aware that there are a lot of reporting requirements in this area, so we must consider the climate/social and transition planning reporting in the context of the wider reporting framework and what companies are already reporting.

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

We agree it is important for the board to take social matters into account as well and we welcome this additional wording in section 1. If the code requests boards to report in the annual report on environmental and social matters, it should also ensure wording is included on upskilling and training in the code. This will help ensure boards have adequate skill and due diligence to oversee these new functions. Many directors will not have a substantial level of knowledge around ESG factors and long-term climate issues, which will affect their ability to report how they govern these risks and opportunities.

Importantly, we would argue that the FCA should reconsider its proposal to change the current framework on the 'one share, one vote' principle. However, if this proposal becomes part of the listing rules, regarding companies fully complying with Principle C in Section 1 to "ensure effective engagement with, and encourage participation from, [shareholders and stakeholders]", we would argue Provision 3 be amended to include wording around – 'where a dual-class share structure has been used – the board ensures it listens to and acts upon views expressed by shareholders'. In addition, we would ask that in the interest of protecting shareholders and other stakeholders, the FRC include wording that warns of the risks of dual share classes and request that companies provide robust reasoning if they choose to use them.

We would like to see reporting in the context of how the board has identified and understood the risks that are most pertinent to their business.

Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

We agree with the proposed change to Code Principle K, as highlighting the issue of significant external commitments in board performance reviews. Evaluating directors' commitments within other organisations annually will provide shareholders and stakeholders with a fuller understanding on whether each director can fulfil their roles at the respective company effectively. Better oversight of external commitments may help improve UK board diversity in the long run by identifying where a small number of women have multiple roles on boards, rather than companies hiring more women into senior director positions. This point is also relevant regarding ethnic diversity on the board, we would want to see companies hiring more ethnically diverse people into senior director positions. We also welcome the proposal to promote diversity and inclusion in board appointments and succession planning which can lead to better functioning and more effective boards.

Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

We agree with the proposed changes. We support greater transparency around directors' commitments to other organisations and believe highlighting these in the annual report will ensure there is confidence among shareholders and other stakeholders. This description should include outcomes related to assessments and detail on number of board meetings attended. In principle, we would argue external director commitments should be taken into account when voting for directors at AGM's. Guidance should be provided by the Code on what reporting on director commitments should look like, so that there is consistency among companies and investors can compare them easily.

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

Yes, we agree the proposals outlined strengthen and support existing regulation. We believe it is it sensible for companies to describe in the annual board performance review how each director has time to undertake their role effectively, but only where there is a new director appointment and if any existing directors have started other commitments in the past year. We don't think it necessary for investors to see this information routinely every year to help with duplication and burdensome reporting.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

Whilst we welcome the proposal to explicitly promote diversity and inclusion in board appointments and succession planning which can lead to better functioning and more effective boards, we do not support the changes to move away from a list of diversity characteristics towards pushing companies to tackle a wider range of 'protected and unprotected' characteristics. Companies should be able to cite and explain their own set of diversity and inclusion criteria that's addressed within their business, but the characteristics identified in the existing Code help provide a starting point. We agree with the FRC that guidance here should be consistent with other mandatory requirements and voluntary initiatives, but we don't believe the use of the terms protected and non-protected characteristics is consistent with current policy wording and could promote a level of opaqueness and a tick box approach to diversity and inclusion reporting.

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

We agree with the changes made to provision 24. They offer a transparent approach to reporting on succession planning and appointments. The level of detail proposed is good and will allow for a clear process to be highlighted, however given the level of detail it will be important to ensure that there is no duplicate reporting. We particularly support the

transparency on the effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives. Currently, companies have policies in place but lag when it comes to reporting on their progress and performance so this will provide a valuable step in the right direction. We also welcome proposed reporting on the gender balance of those in senior management and direct reports. This will ensure that companies think about diversity and inclusion at all managerial levels. However, as is consistent with the new FCA policy wording which focuses on both gender and ethnic minority representation, we question why the FRC wouldn't also include reporting expectations on ethnic minority representation and would encourage it to do so.

Q9: Do you support the proposed adoption of the (Chartered Governance Institute) CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

We support the proposed adoption of the CGI recommendations as set out above and there are no particular areas we would like to see covered that have not already been included.

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

We agree that all Code companies should prepare an audit and assurance policy on a 'comply or explain' basis using legislation as a guide. This allows companies to have freedom to explain their ongoing situation in cases where they have not been able to prepare an audit and assurance policy under legislative requirements. Ensuring the integrity of financial statements and reporting is of key importance and should remain a significant part of the Code. There should be a rigorous process in place to assess if the 'explanation' is a satisfactory reason for being non-compliant. However, there should be guidance on reporting that reflects the different levels of maturity of companies, so reporting is not overly burdensome for smaller companies who are striving for the same reporting standards as the larger companies.

Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

We agree amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication. It allows for extensive rules to be followed, whilst not being overly burdensome.

Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

We agree that sustainability reporting and ESG metrics should be considered by audit committees. For investors, incomplete and inconsistent reporting on key ESG metrics continues to be a challenge in meeting our own ESG objectives. Having the Audit committee verify and monitor the integrity of reporting that's financially complex or requires a level of judgement

would give investors' confidence in the data that's being presented by the company. Their role and responsibility however should be clearly identified and communicated to investors on where they fit in the process of ESG reporting. Sustainability reporting checks will also align with the board's new role reporting on the company's climate ambitions and transition planning. However, we would welcome and encourage joined up working between committees, such as the Sustainability committee and Audit committee.

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

Yes, we would agree that the proposed amendments to the Code strike the right balance between strengthening risk management/internal controls whilst not overly complicating the existing requirements. The number of the amendments are small, but have positive meaning that we believe will lead to proportionate outcomes. Developing and implementing policy on the engagement of the external auditor to supply non-audit services and report to the board, will help strengthen risk management and internal controls. In addition, having an extra requirement in the Code for the Board to explain in the annual report what procedures are in place to identify and manage emerging risks, will certainly strengthen risk management systems from an investor perspective.

Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

We would suggest the board's declaration should be based on monitoring up to the date of the annual report, which will allow for the most up-to-date review of certain risk management and internal controls.

Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

We support advocating for wider reporting controls rather than just financial reporting.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

It is always helpful to provide examples of methodologies and frameworks for companies to refer to, including when reviewing the effectiveness of risk management and internal controls systems. The improvements to the Code should aim to help companies get better at reporting and make it easier and less time consuming for them, whilst ensuring full coverage of all principles. Providing examples of methodologies will hopefully encourage a smooth transition for companies to adopt new, effective, risk management and internal controls systems. Guidance should reflect the differing levels of maturity on reporting and also take into account

a company's size. We would argue that the FRC should not make the guidance too prescriptive as this could lead to tick box reporting and it would be good to see a degree of flexibility and freedom.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

No

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?
We would argue it would be useful to see risk management and internal controls around modern slavery and human rights risks within business operations and wider social issues. This would be guidance on what best practice looks like from a performance and action perspective, as well as how to report on it effectively. Respect for human rights in business is strongly associated with value chain resilience and we are aware of the operational, financial, legal, and reputational risks companies may face when they fail to manage these risks.

Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

We have no comments on this question.

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

We agree that all Code companies should continue to report on their future prospects, which helps alleviates shareholder and wider-stakeholder concerns about the future direction of the company and how they aim to deal with long term material risks such as climate change. It is also helpful for companies to report on new long-term risks and ambitions and changes from their current business model.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

To a certain extent the Code provides sufficient flexibility for non–public interest entities (PIEs) to report on their future prospects. In some cases, the flexibility is limited, and the reporting requirements are quite extensive, so should allow for greater flexibility for non-PIEs. For example, the FRC may wish to consider simplifying legislative guidance for non-PIEs producing an Audit and Assurance Policy, ensuring the framework is flexible enough for companies of different maturities and sizes.

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

Yes, we agree that the proposed revisions might strengthen the links between remuneration policy and corporate performance. However, we would also welcome companies' explaining the factors that make up their corporate performance, so stakeholders fully understand what they are basing remuneration outcomes on. These is a slight danger that remuneration

outcomes are based solely on financial corporate performance which might have little to do with the CEO's management of the company. This should be explicitly discouraged by the FRC. We welcome the additional wording around remuneration being aligned with the company's long-term strategy including the successful delivery of environmental, social and governance objectives. Where companies do link ESG objectives to performance, it should clearly state how these objectives are measured and evidenced, to provide shareholders with confidence. We believe that linking pay outcomes to purpose and values could be tricky and difficult for companies to effectively measure and evidence. These are areas that could be considered in malus and clawback reporting where directors have found not to have acted in line with the company's values and purpose. Finally, we welcome included wording on engagement with the workforce and an explanation of the remuneration committee's approach in rewarding the workforce.

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

We agree that the proposed reporting changes around malus and clawback will result in an improvement in the minimum benchmark in this particular area and enable investors to better understand how companies have addressed misconduct and serious failings. The reporting changes provide good guidance to companies on what to include in their reporting on malus and clawback provisions. Although, there is always a risk by having stricter malus and clawback reporting proposals in place as companies will offer remuneration terms in different ways through contract that mitigate those risks. We also don't believe these changes to Malus and Clawbacks will necessarily lead to an improvement in transparency in other areas of the remuneration report. However, they remain a good addition to remuneration reporting.

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

Yes, we agree with the proposed changes to both provisions 40 and 41.

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

The reference to pay gaps and pay ratios should not be removed. It could be strengthened through adding wording on alignment of executive pay with the median, 25th and 75th percentile of the company to strengthen the overall company pay policy. Companies could also be asked to explain how their reporting on pay gaps and pay ratios have led to improved pay structures and policies and less egregious executive payouts.

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

With the rapid development of AI and the current lack of regulation, we think it could be worth adding a question on whether or not the FRC support internal and external audits undertaken by artificial intelligence and if they do support it, what provisions are in place to check its compliance with the UK governments white paper on artificial intelligence. We recognise that AI could bring several benefits to the UK financial system, including efficiency, accuracy, greater monitoring capabilities and cost savings, all of which can be applied in the case of audits. However, it will be important to ensure AI has a strong regulatory framework. There are still issues regarding data quality, security and ethical concerns, all of which will pose a risk

when conducting audits. As a result, it would be helpful if the Code provides some clarity on its views of AI audits and what the regulatory framework might look like.

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