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Proposed Revisions to the UK Corporate Governance Code

About us

UK Finance represents nearly 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance was created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association. Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities. The interests of our members' customers are at the heart of our work.

Introduction

As the consultation recounts, the primary duty of directors is to promote the long-term success of the company. In this they have been supported by core components of the UK's approach to corporate governance – the unitary board, strong shareholder rights, the role of stewardship and the flexibility afforded through the 'comply and explain' provision.

In proposing revisions to the UK Corporate Governance Code ('the Code'), the FRC has sought to:

- Shorten and sharpen the revised Code, by making a clearer distinction between Principles and supporting Provisions, and separating guidance on Board effectiveness; and
- Place greater emphasis on the openness and accountability essential for a healthy culture, including the demonstration of good governance through the way in which a company conducts business and engages with stakeholders.

A further turning of the dial is the proposed shift in emphasis away from the 'comply or explain' aspects of the Provisions towards the application of the Principles, and the heightened expectation for the company to justify to shareholders why the board has implemented certain structures, policies and practices, linking the Principles behind these to the company's strategy and business model and the outcomes achieved.

As revised, the Code can therefore be seen to have sharper edges for leading corporates given that Listing Rule 9.8.6 (5) requires all Premium-listed companies to disclose how they have applied the Principles in a manner enabling shareholders to evaluate their application.

In including a new focus on stakeholders, integrity and corporate culture, diversity and how the overall governance of the company contributes to its long-term success, the FRC is proposing that the Code reflect the broader Government initiative to raise the quality of corporate governance within the UK based upon developing best practice within the marketplace.

UK Finance is supportive of this in principle and overall views the proposed changes to the Code to be in keeping with the objective of raising standards of accountability and openness without imposing disproportionate burdens on companies. This said, the proposed approach constitutes a significant shift in emphasis in the expected application of the Code and we recommend that the FRC reviews this at a future point in light of experience.

There are also one or two specific areas that merit reconsideration. We outline these in our response to the specific questions raised in respect of the Code, which we turn to once we have answered the questions relating to the Code application date and the amended guidance on board effectiveness. They relate in particular to:

- the question of whether the proposed revisions achieve the right balance between independence and experience in respect of board chairs; and
- the need for a refinement to the proposals on remuneration deferral in order to better align the Code to the detailed regulatory regime applying to financial services companies.

We see the Stewardship Code as a core part of the corporate governance framework and are supportive of the intention to review the format and content of the Code.

We are also interested in the work planned on the development of corporate governance principles for large private companies and plans on the part of the FRC to monitor corporate governance reporting and look forward to hearing more on these.

Q1. Do you have any concerns to the proposed Code application date?

No. We are content that 1 January 2019 is a realistic start date providing as planned the FRC publishes a final version of the Code by early Summer 2018.

Q2. Do you have any comments on the revised Guidance?

The amended *Guidance on Board Effectiveness* looks to us to be entirely in keeping with the Code changes and broader expectations upon Boards around relations with shareholders, employees and other stakeholders, for the framing of culture, and for the division of responsibilities between directors and their oversight responsibility for workforce pay, conditions and policies. As redrafted, the guidance provides a really useful outline of the types of factor that contribute to board effectiveness.

Section 1 – Leadership and purpose

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

Provision 3 includes the three options identified in the Government Green Paper Consultation on Corporate Governance Reform for ensuring the employee voice is heard in the boardroom; we believe this to be the right approach for the reasons given by many at the time of the Government consultation.

We further note that Principle D provides that the workforce should be able to raise concerns in relation to management and colleagues where they consider conduct to be inconsistent with the company's values and responsibilities and that this is supported by provision for there to be the means for the workforce to raise concerns in confidence and (if they wish) anonymously, and for there to be arrangements in place for proportionate and independent investigation of such matters and for follow-up action. This represents a reasonable general expression of the more defined whistleblowing requirements that can be found within regulated industries, including financial services.

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?

As the consultation explains, the *Guidance on Board Effectiveness* includes provision on the need for boards to account for the impact of the company's operations on a wider range of stakeholders, complementing earlier proposals for revisions to *Guidance on the Strategic Report*, enhancements to Section 172 director's duties and other guidance on boardroom engagement published by ICSA: The Governance Institute and the Investment Association. It then refers specifically to the report *Growing a Culture of Social Impact Investing in the UK* published recently by the independent Advisory Group to the Department of Culture Media and Sport and the Treasury asking the question of whether more specific reference be given to the UN Sustainability Development Goals (SDG) or other NGO principles within the Code or (Board Effectiveness) Guidance.

Companies will be guided by UN Social Development Goals, the Equator Principles or other sustainability objectives relevant to their operations including, for instance, the recommendations of the FSB-sponsored Taskforce on Climate-Related Financial Disclosure (TCFD). This said, we consider the approach proposed under

Principles A to D and the supporting Provisions to be the right one, i.e. defining the function of a successful company as promoting the long-term success of the company, generating value for shareholders and contributing to wider society, and requiring the board to explain how it has engaged with the workforce and other stakeholders on how their interests and the matters set out in section 172 of the Companies Act 2006 influenced board decision-making.

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?

Yes. This is in keeping with the intention that companies place greater emphasis on stakeholder engagement and consistent with the basis upon which the Investment Association will run its public register of resolutions that either receive a high vote against or are withdrawn.

Section 2 – Division of responsibilities

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.

We believe the update to be in keeping with contemporary good practice followed voluntarily by many well-run companies outside the FTSE 350. In removing the exemption, however, we would suggest that the FRC include a specific reference to a proportionate approach being followed.

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

The question in part relates to one of the most significant changes in the draft Code revision i.e. the proposal that the Code includes the chair within the requirement that a majority of non-executive directors be independent, and that this includes the criterion of not having served on the board for more than nine years from the date of their first election. While the consultation says that the FRC 'recognise that in some circumstances companies can explain if they wish to retain a non-executive director and/or chair beyond nine years', it is evident from reporting that the provisions of the Code in this area are likely to be regarded as a bright line¹. While we would not necessarily argue against the direction of the proposed revision, we can see a need for mitigation if it is in fact the case that this would overnight place one in five FTSE 350 companies in a position of having to explain their approach.

If accepted, the question is then whether mitigation should take the form of a transitional or permanent arrangement. We potentially can see a case for both, with the Code making provision for the chair to serve on the board for a limited period of time prior to their appointment as chair *without the nine year clock ticking* and also the FRC making clear it does not expect the change should, other than in extreme cases, result in an expectation that companies change their succession plans for their chairs.

The alternative would be to cast a shadow over the governance of a significant proportion of the UK's largest companies as a result of the introduction of new provisions not matched in requirements that are in place in other major economies. It would also place a time bar on the period for which a chair can serve that we consider would fall short of achieving an appropriate balance between independence and experience.

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

Yes. It is sufficient that after a set period the non-executive director will no longer be regarded as independent. While the nine year point is increasingly seen as the maximum period for which a non-executive director should serve, given the benefit accruing to independence, this provides an appropriate measure of flexibility for non-executive directors to be retained in justifiable circumstances.

Section 3 – Composition, succession and evaluation

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?

The proposed changes in Section 3 are reflective of practices that we believe should define a well-run company in modern Britain. Clarity, for instance, that 'senior management' for Hampton-Alexander purposes comprise the Executive Committee or equivalent first layer of management below board level and their Direct Reports is both appropriate and helpful. It is further worth noting that, as of November 2017, 162 financial services organisations – including UK Finance - had committed to achieving stretch gender diversity targets under the HM Treasury Women

¹ See, for instance, ['UK corporate governance code to hit dozens of chairmen'](#), Financial Times, 11 December 2017.

in Finance Charter following a review of female representation in the senior management of financial services organisations undertaken by Jane-Anne Gadhia. In doing so, many have ensured that their gender diversity policies sit firmly within a People Strategy that seeks to promote diversity and inclusion across gender, social and ethnic backgrounds as reflected in the proposed revision to the Code. We are strongly supportive in principle.

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.

We agree with the proposal that all companies be encouraged to increase transparency on gender balance.

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.

The draft revision, as set out in proposed provision 23, is to ask nomination committees to explain the actions they have taken to increase diversity in the pipeline, but to extend the data reporting requirements to gender only. We agree with this, including the less prescriptive approach to data reporting beyond gender due to the practicalities and sensitivities involved, including unease within the workforce. As companies roll out diversity policies other than gender in their senior management pipeline, they may wish to consider the feasibility of gathering data. We do not, however, see this as something that could be prescribed upon first time application of the revised Code.

Section 4 – Audit, risk and internal control

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?

Yes; we view the overlap as helpful.

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

The proposed removal in effect places the main board committees onto the same footing and is supported.

Section 5 - Remuneration

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?

Yes. As related in the consultation, the draft revision proposes that the remuneration committee be given strategic responsibility for demonstrating how pay and incentives align across the company, combining with expectations for reinforced workforce engagement and enhanced discipline in ensuring pay policies support the long-term success of the company, including an extension of the recommended minimum vesting and post-vesting period from three to five years and planned new statutory reporting requirements on pay ratios and on the range of remuneration outcomes of complex, share-based incentive schemes.

While these changes are very much in the direction of travel of measures introduced in financial services in recent years with the aim of ensuring that remuneration is more closely aligned to the long-term performance of the company, the FRC may wish to consider suggesting that the minimum vesting and post-vesting holding period being 5 years *overall*. This would better align to more detailed regulatory requirements for senior employees which typically require variable pay to be deferred over three to seven years with an additional one year post-vesting holding period.

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

Planned measures overall are mutually reinforcing and will serve to raise standards in the design and implementation of remuneration policies.

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

Principle Q implies closer attention being given to remuneration outcomes in light of company, individual and wider circumstances.

For further information on this submission please contact Paul Chisnall, Director, Finance Policy & Operations, UK Finance paul.chisnall@ukfinance.org.uk