

19 February 2018

Dear FRC

YOUR PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

I am pleased to have the opportunity to respond to your consultation on the revised UK Corporate Governance Code (“revised Code”, generally “Code”) and revised Guidance on Board Effectiveness (“revised Guidance”, generally “Guidance”).

I understand that you intend the Code to set out general principles that are relevant for all companies. Dictionary definitions of the word ‘principle’ include phrases such as ‘a rule of conduct’, ‘a fundamental, primary or general law or truth’ and ‘a fundamental doctrine or tenet’. The Cadbury Report of 1992 referred to three principles – openness, integrity and accountability – on which the first Code was based. Its leading requirement, that power and authority be balanced between executives and non-executives, is now an accepted rule of conduct for good governance.

The government’s recent inquiries indicate that there is a need for this principle of balanced power to be re-emphasised in the light of developments both in corporate practice, especially in relation to executive pay, and in society generally, especially as regards diversity in public life. Efforts have been made to address this in the revised Code and revised Guidance, and I note that time has been allowed for these to be further developed.

A notable feature of the revised Code is the sheer amount of prescriptive detail that has been packed into its seventeen Principles and forty-one Provisions. Starting, it seems, from ideas about suitable procedures rather than from principles, many of its requirements raise questions or introduce competing themes that make interpretation harder than perhaps is necessary or helpful for directors with the duty and power to act as they see fit to promote the success of the company.

Nevertheless, despite its disadvantages, it seems to me that the intention and direction of the revised Code is broadly right. I take this opportunity to offer, in Appendix 1, some suggestions for its further development that I hope will assist efforts to make it shorter and sharper while retaining the essence of what it is trying to achieve.

My responses to your questions are set out in Appendix 2 and aim to provide some justification for my suggestions in Appendix 1. I would be happy to provide further clarification should you need it.

Yours faithfully

Jeannie Okikiolu, MA FCA

Appendix 1 – suggestions for the Code and Guidance

Code – outline of contents

1. The board's primary function is to direct and control the activities of the company on behalf of its shareholders. The duties of an individual director are prescribed as [insert s.172 of UKCA]
2. The board shall consist mainly of non-executive directors selected for their ability to ensure that the board fulfils its primary function. Non-executive directors will, collectively, be:
 - *enterprising* in acting with energy and initiative;
 - *commercial* in their ideas for generating profits on a long-term basis;
 - *prudent* in their sound judgement, careful management and economy; and
 - *responsible* in holding themselves answerable and accountable for their conduct.
3. The following matters shall be reserved for the non-executive directors who will make final decisions without the presence of the executive management:
 - i) deciding in what business the company is to engage;
 - ii) deciding the essential features, as the board may determine from time to time, of how that business is to be conducted;
 - iii) appointing executive management (who may be directors) to run that business;
 - iv) deciding terms of employment for the workforce including executive management;
 - v) reporting to shareholders on the company's results and its operation.
4. The board will establish such committees as it deems necessary to conduct its business efficiently and effectively.
5. The board shall be led by a chair who will
6. The board shall be advised by a company secretary who will be responsible for
7. Annual reports to shareholders will include, in addition to the matters required by [insert statutory references]

Guidance

The Guidance might, in relation to section 3 of the above outline, draw attention to relevant matters such as viability assessments for point (i), questions of ethics and sustainability for point (ii), and high-level considerations for appointing and monitoring executive management, deciding terms of employment and reporting to shareholders for points (iii), (iv) and (v). The Guidance might also, in relation to section 4, remind boards that a committee may require any member of the workforce to attend before it.

Appendix 2 – response to the questions

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

No.

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

The revised Guidance does not take the right approach for guidance at this level, in my view: it is too long and sets out what needs to be done in too much detail. No doubt this is because it is designed to support the revised Code, about which I have similar feelings. However, I hope that other uses can be found for the revised Guidance as it has been prepared with such care and diligence.

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

No. I think it is counter-productive for companies to have bureaucratic solutions imposed on them. Boards already have the power to hold executive directors to account for any failure to address workforce issues. If these issues need more attention, the Code/Guidance can best assist by reminding boards of their responsibilities in relation to the workforce and encouraging non-executive directors to play a stronger part.

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?

Yes, probably, maybe in an Appendix to the Code or the Guidance. As things stand, Principle C, Provision 4 and parts of Principle A are difficult to interpret.

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, but in my view the figure of 20% should be offered only as guidance in the event that the need for further action cannot be assessed by reference to the nature of the issues giving rise to shareholder dissent.

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.

That the question arises suggests the matter is better dealt with in the Guidance. Indeed, since an independent evaluation is a potential means of improving board effectiveness, it is logical to deal with it in the Guidance.

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

That the question arises suggests the matter is better dealt with in the Guidance.

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

That the question arises suggests the matter is better dealt with in the Guidance.

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

No. I cannot see how Section 3 helps anyone to understand why diversity is important. If it is desired to promote diversity, the Code can best assist by reminding the board of its responsibilities in a way that makes clear why diversity is necessary for it to fulfil them.

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.

That the question arises suggests the matter is better dealt with in the Guidance.

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.

I think it is fine, in principle, as long as it can be done without encouraging the proliferation of diversity questionnaires. I suggest that the 'comply or explain' requirement be confined to *developments* in the executive pipeline, while the Guidance draws attention to aspects of current interest.

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?

No. The Code should not appear to prioritise some of the board's functions over others, in my view, in case that influences how boards distribute their attention and resources.

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.

Yes.

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, if wider remit means setting remuneration for the whole of the workforce including directors by reference to the same set of criteria. The most effective way to discharge this responsibility is for the board to ensure that the non-executive directors play a strong part in directing and controlling matters pertaining to the workforce (see also my response to **Qu3**). How this is achieved in practice is for boards to decide taking account of their company's circumstances.

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

I think that the Code need do no more to support executive remuneration and would be better used to focus attention on the achievement of long-term sustainable performance.

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

No. I think that the revised Code imposes too many procedures that might not represent complete solutions for every company but might crowd out other, more effective, action. The following are examples.

- Provision 3 specifies three methods for “*gathering the views of the workforce*” which boards might find useful guidance; however, restricting options to just these three methods is an unnecessary constraint (see also my response to **Qu3**).
- Provision 5 requires that chairs should actively “*seek*” regular engagement with major shareholders to understand their views on governance and performance, which appears to exclude the views of other shareholders. I suggest that the Code specify what percentage shareholding counts as ‘major’ for the purpose of inviting an individual shareholder’s contribution to the governance of the company.
- Provision 6 specifies a level of shareholder dissent of 20% above which further action must be taken. The 20% bar might exclude cases where further action is desirable because dissenters can show important reasons for their dissent (see also my response to **Qu5**).
- Provision 8 sets out only some of the steps that directors might wish to take when they have concerns about the operation of the board or the management of the company.
- Provisions 9 and 10 specify a board structure that includes a chief executive whose role is one of “*proposing strategy to the board [and] delivering it as agreed*”. That does not reflect the practice in all companies or of all chief executives.
- Provisions 11 and 13 address the role of the non-executives. Their first sentences are, I think, fundamental for good governance. The rest seems to be a matter of guidance, although it would be wrong for the Guidance to suggest that behaviour can be fully specified by way of performance objectives.
- Provision 14 frames the requirement for directors to devote sufficient time to their duties in terms of the number of other appointments they have, which is not in itself a sufficient or even necessarily a relevant criterion. Also, it would be wrong for the Guidance to appear to encourage full-time executives to take on another appointment, in my view.
- Provision 15 focuses on the independence of non-executive directors, listing a number of factors that seem to be guidance on what might give rise, or be seen to give rise, to threats to independence or objectivity. A more balanced approach would address threats to the independence and objectivity of both executive and non-executive directors.

- Provision 20 recommends using open advertising or search consultancies to find new non-executive directors. However, neither method is sufficient by itself to ensure that the selection process is rigorous and transparent as required by Principle J.
- Provisions 21 and 22 refer specifically to the evaluation and enhancement of board effectiveness so are obvious matters for the Guidance. However, I think it would be wrong for the Guidance to suggest that performance evaluations and personal development plans are the only, or necessarily the best, way to achieve board effectiveness.
- Provisions 34 to 39 offer detailed guidance, in my view, although it seems unnecessary for the Guidance to appear to encourage the use of remuneration consultants or share schemes.