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By email: codereview@frc.org.uk

Dear Catherine

Consultation: Proposed Revisions to the UK Corporate Governance Code (the "Code")

We provide this response to your consultation on behalf of and from the point of view and experience of the Invesco UK Equities team, whose managed funds invest mainly in Code relevant companies.

We attach our answers to the questions in the consultation document in the appendix to this letter.

Our general view, as fund management investors, is that the UK corporate governance regime continues to be reasonably fit for purpose. This view has not changed since the last review and revision of the Code. However, all processes may be improved and we welcome this consultation opportunity to reply and provide some thoughts on where these improvements may be made.

Our starting point is the following principles:

- We believe the current regime is working well and meeting the main requirement of the Code being the encouragement of companies to provide evidence of appropriate governance structures being in place.
- We act in our funds' investors' best interests and we manage as required by financial services regulation anything that conflicts with this.
- We recognise our responsibility as agent representatives of the beneficially interested shareholders to question companies' boards and management in satisfying ourselves that appropriate governance structures are in place.

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- We require our investee companies to have the necessary time and resources to decide how they should operate and not be distracted from their agreed core strategies.

Therefore the shareholders' role as articulated in the Introduction to the Revised UK Corporate Governance Code – "The shareholders' role is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place" - makes sense to us.

This shareholders' role should also be the main context of the UK Stewardship Code as it is important that the responsibility and accountability of a company's actions remain with its Board. It also resonates with the requirement of directors to act in a way they consider in good faith would be most likely to promote the success of their companies for the benefit of its members as a whole (or other purposes if replacing the success of the company) as required by section 172 of the Companies Act 2006 ("Section 172").

Introduction, reporting on the Code and Application

It would be helpful to emphasise or separate out the objectives and/or purpose of the Code set out in the introduction; in particular to demonstrate how the governance of the company contributes to its long term success and "comply or explain".

The word "comply" in "comply or explain" may drive a company's corporate governance thinking towards compliance and seeing the Code as a set of rules. Alternative words should be considered such as either "apply" or "implement". There should also be a reference to using proportionality in explaining any principles that may not be applicable to a company's circumstances.

We support the proposed revised drafting of the Code and the resulting focus on the Principles. We believe it maintains the spirit of the original and last revision, which is right in the context of our view that the UK corporate governance regime continues to be reasonably fit for purpose.

Section 1 – Leadership and purpose

Principle A's first sentence may read better if worded "A successful company is led by an effective board, whose function is to promote the long term value of the company for shareholders and other key stakeholders." We do not believe all successful companies' boards have to be entrepreneurial in the dictionary sense (for want of a better definition) of running a business with considerable initiative and risk. We know Section 172 references the success of the company but this drafting does not recognise that success may sometimes mean knowing when for example to cease operations and protect value through an orderly wind down. The Code should also maintain the primacy of members as a whole (shareholders) as articulated in Section 172. Principle C should therefore have the words “other key” before stakeholders.

Provision 3 should be less specific about the methods of gathering the views of the workforce and should not promote any one method, for example “this would normally be a director appointed from the workforce”. We believe in the majority of UK businesses that methods of gathering views of the workforce are already in place and therefore all the Code needs is a requirement to articulate and report these.

If not required elsewhere and in the context of section 172, Provision 4 should be promoted above Provision 3 and amended to require companies to identify their key stakeholders, report on their engagement with these and on how these engagement processes have worked and influenced their decision making. This would then indicate that the workforce is one of many key stakeholders and not necessarily the primary or main one.

Provision 7 should replace the word “eliminate” with “manage” as attempting to eliminate all conflicts of interest may have unintended consequences, such as incurring excessive time and money costs and, depending on the conflict, may not be possible. It may be worth differentiating in any related guidance that this refers to actual material identified conflicts of interest and not perceived conflicts.

Section 2 – Division of responsibilities

Principle E should reflect that the chair should ensure the effective contribution of all directors, not just the non executives; as the board should behave as a team.

This section suggests a problem that needs fixing by having a majority of “independent” non executive directors including the chair. We believe the problems are group think and one person or a group having unfettered powers of decision making. In which case, these or any other relevant problem should be articulated.

In addition, “independent” needs to be defined and then suggestions made as how to assess this on a principles basis and not on a set of specific criteria. We would suggest the definition is “not subject to another's authority or jurisdiction; autonomous; free” and it should be assessed on a regular basis by the board effectiveness review. We therefore suggest provision 15 is too specific and may need amending to allow for a qualitative as well as a quantitative assessment of independence as required in the context of good corporate governance. If any quantitative assessment criteria remain, companies should then be able to explain why they think a director is independent despite some of these criteria. For example, an ex employee could be free of their company's authority and therefore autonomous and able to provide a challenge or contrary view in board discussions and decisions. It should also recognise that independence is not necessarily time limited or conflicted with being a shareholder.

Section 3 – Composition, succession and evaluation

In general we support the promotion of diversity on boards as it protects, like independence, against group think. However, we believe that being too specific about diversity may result in those specifics conflicting with a board having an appropriate balance of skills, experience, independence (in the definition given above) and knowledge. We would expect companies to come up with their diversity policies and plans, aligned to a board having an appropriate balance of skills, experience, independence and knowledge, and report against these.

Principle I should have the word "appropriate" inserted before balance of skills.

Principle J should not be specific on diversity and stop after the word "diversity".

Section 4 – Audit, risk and internal control

We have no issues with and are supportive of this section.

Section 5 – Remuneration

Principle O should replace "success" with "value" (see comments re Section 1 above).

Somewhere in this section, the existing Code's supporting principle of boards avoiding paying more than is necessary should be included.

As anticipated by provision 33, the remuneration committee should not oversee remuneration and workforce policies and practices as it will have enough to do determining director remuneration policy and setting remuneration for directors and senior management. However, it should ensure that its director remuneration policy and the setting of remuneration for directors and senior management do not conflict with the company's remuneration and workforce policies and practices.

Provision 34 should clarify that share based rather than cash based remuneration payments may be acceptable. Similarly, in thinking that any director holding shares in the company aligns them to members as a whole (Section 172), provision 36 should remove the word “executive” from in front of “directors” in its first line.

If you need to discuss anything further or clarify our answers, please call me to discuss.

Yours sincerely

Charles

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Appendix: Consultation Questions – Proposed Revisions to the UK Corporate Governance Code

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?

No, as we have not had time to review the revised guidance in full. However, you should refer to our key thoughts in our letter above and our other responses to your questions below.

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

No, as we believe that in general boards have always considered the needs and views of key stakeholders in their businesses. We are not aware of any of the management and boards of our invested in companies not considering the needs and views of their workforces. Therefore we believe there is no need for specifying methods as proposed in Provision 3 to achieve meaningful 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?

While the Code should avoid specifics, we believe there may be benefits to include ESG requirements in the guidance to support the identification of material ESG matters and consistency of reporting on these matters.

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, we agree that 20% is significant. No we do not agree that an update should be published no later than six months after the vote. There should be no time requirement for an update and companies should be provided the flexibility to publish updates when appropriate for their circumstances, which could be in the next annual report or notice of AGM.

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, provide information relating to the potential costs and other burdens involved.

Yes, especially as we believe that the Code should be applied proportionately for each company's circumstances and non application explained. Therefore, we expect all our invested in companies, whether FTSE 350 or not, to apply good corporate governance practice and we believe this is articulated in the Code. However, third parties with a strict compliance and tick box mentality should not criticise companies for not applying immaterial irrelevant parts of the Code that the companies have explained away unless those third parties are able to demonstrate that the parts of the Code are material and relevant to a company's business.

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

No, as independence should be defined in the context of whatever problem it is trying to fix and not in terms of specifics such as time served. As, along with others, we believe that boards, management and workforces of our invested in companies should have "skin in the game", we struggle with "independence" being a good thing. However, we also recognise the dangers of group think and a company's governance structures and processes should be such as to guard against this.

It is important to us that all directors are presumed to have the interests of members as a whole in mind unless shown otherwise.

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

Yes, we agree.

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?

We do not agree that the overall changes proposed will lead to more action to build diversity in the boardroom etc as we believe that such actions are already happening and should be given a chance; and other factors, such as the education of prospective board members, executives and workforce, need to be addressed to improve the practical chances of diversification in the future.

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.

Yes, we agree.

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.

There is always a danger in treating differences in diversity, whether it is gender, ethnicities or other, that it accentuates the differences and becomes counterproductive. It may be helpful to report levels of ethnicity in executive pipelines if levels of ethnicity are statistically significant and relevant to a company.

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. However, the Code is probably better placed to encourage good practice and cultural alignment in companies to do the right thing rather than promoting compliance and tick box mentality in business processes and reporting. We believe that the FRC may promote such an attitude through appropriate drafting of the Code and encouraging appropriate application of the Code, especially proportionately and in allowing explanation of non application to be seen as compliance.

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?

No. We see no need for a wider remit of remuneration committees in the companies in which our funds are invested. In satisfying ourselves that appropriate governance structures are in place, we already see good practice in this area in executive remuneration policies being aligned to those for the rest of the workforce. We believe that if such policies were not aligned, it is highly probable that an organisation breaks down through the workforce, as a key stakeholder, being disincentivised. We also understand from our remuneration engagement experience and from remuneration consultants that the changes to remuneration practices and reporting four or so years ago are beginning to show executive pay restraint. We believe this continues and should be given time and more chance to show those changes working in practice. Therefore we have no suggestions on ways to discharge the proposed new responsibility as we do not believe it is needed.

There is already too much focus and engagement on remuneration and this may be to the detriment of other important areas.

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

No, as ways in which executive remuneration may drive long term sustainable performance should be determined by companies and approved by their members as a whole as it is very unlikely that there will be specific ways which fit all companies.

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

No, as we believe they already have this and will exercise discretion as appropriate.

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 or different categories of the investment chain help drive best practice?

No. We believe the Stewardship Code is currently fit for purpose. We believe in the primacy of equity shareholders or members of a company as a whole in UK company law, including of their agents acting on their behalves such as ourselves. This is because they are the providers of ultimate financial capital to companies and therefore are the only key stakeholder in the value creation chain who risks losing it.

Therefore, we are unable to see what different expectations there could be of the different categories of the investment chain as they all should be putting themselves in the position of shareholder/owner of a business. This expectation should be to appoint the directors and auditors of a company and satisfy themselves that an appropriate governance structure is in place. The Stewardship Code policies should then support the process around this shareholder role in governance, which we believe it does.

However, the Stewardship Code could provide enhanced clarification and guidance on its scope (eg including pension funds and other asset classes), the purpose definition of stewardship (eg satisfying themselves that an appropriate governance structure is in place) and what signatories are required to report to demonstrate compliance with the principles.

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?

The Stewardship Code should focus on good rather than best practice expectations as one size will not fit all situations. We note that achieving best practices should be aspirational; however not all companies will be able to achieve this and should therefore not be judged on such expectations. These should be determined over time by monitoring the practices of the signatories to the Stewardship Code.

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

We believe this could be done by reintroducing an annual monitoring survey, similar to the previous Investment Association's, and enhancing this by focusing it on the Stewardship Code requirements of signatories and leveraging the PRI reporting framework.

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

No.

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

There is no need for the Stewardship Code to do so.

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?

See our answer to Q4. We would then expect our shareholder stewardship role to cover company identified material ESG matters and reporting. Incorporating something on this into the Stewardship Code may have to wait for the follow up of the Code's enhanced guidance on ESG matters.

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?

We would suggest this has already been done through the tiering exercise monitoring, which should continue as suggested in Q19.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

We would suggest all institutional investors are required to carry out responsible investment by regulation and therefore the Stewardship Code does not need to add anything in this respect. However, please see our last paragraph in answering Q17 suggesting the Stewardship Code is not restricted to equity investment.

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

We are not aware of anything.

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

This is a difficult set of questions to answer. Under the presumption that companies are complying with the Stewardship Code and assuming an investor's trust in an asset manager's engagement and voting process, there should be no need for an independent assurance process, which implies that the asset manager is not compliant. This inevitably leads to whether the validator or provider of assurance can be trusted and therefore requires monitoring or regulating or some further independent assurance process and so on.

As a result, we believe that the Stewardship Code is sufficient at the moment as it allows any asset manager to implement an independent assurance process when it needs it engagement and voting processes to be validated for its customers.

Q27. Would it be appropriate for the Stewardship code to support disclosure of the approach to directed voting in pooled funds?

Directed voting in pooled funds may relate to the Association of the Member Nominated Trustees' ("AMNT's") red lines for voting. In which case, this is an industry question, to which our trade association, the Investment Association, should try and find a consensus answer.

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

No. See our comments above, in particular on Section 3 of the Code and to questions 9 to 11.

Q29. Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

In general no, unless a company has identified adapting to climate change a material or key consideration in its business model.

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?

No (see comments above) as the Code makes clear that the shareholders' role in governance (and therefore stewardship) is to appoint the directors and auditors and to satisfy themselves that an appropriate governance structure is in place. It is implicit that an appropriate governance structure is one that ensures alignment as far as possible between the purpose of a company and the benefit of its members as a whole. However, the Stewardship Code could make this purpose of shareholders in governance more explicit.

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?

No. The purpose of stewardship – see our answer to question 30 – is already defined and does not need to be more granular at a fund level.