



Ms Catherine Horton  
The Financial Reporting Council  
8<sup>th</sup> Floor, 125 London Wall  
London  
EC2Y 5AS  
By email: [codereview@frc.org.uk](mailto:codereview@frc.org.uk)

Brussels: 28 February 2018  
Concerning: Proposed revisions to the UK Corporate Governance Code

Dear Ms Horton,

European Investors' Association ("**European Investors**") welcomes the opportunity to comment on the Proposed revisions to the UK Corporate Governance Code ("**the Code**"), published in consultation by the Financial Reporting Council ("**FRC**"). By way of background, European Investors represents the interests of investors throughout Europe. On behalf of our members – a wide range of retail and institutional investors – we contribute to the creation and preservation of sound legislative and regulatory frameworks in Europe. Moreover, our members have significant investments and assets under management in the United Kingdom.

### **1) General remarks & comments on Section 1**

European Investors welcomes the comprehensive review of the Code as undertaken by the FRC. The Code is a global standard in many regards and has been a positive influence on markets in the UK and the wider world for many years. A periodical revision ensures the Code is kept fit for purpose and continues to promote the quality of corporate governance.

European Investors specifically welcomes the preservation of strong shareholder rights. We also support the Code's emphasis on the long-term success of the company and the strengthening of shareholder engagement, for example in Provision 5 of the Code which supports the idea of the chairman engaging with major shareholders to ensure the board has a clear understanding of the views of shareholders.

However, European Investors also wants to share its concerns with regard to Principles A and C of the Code. Both are unclear on their intended application and open to different interpretations. In this regard, we request the FRC to provide more clarity and guidance whether these principles intend to redefine the shareholder primacy model - also known as the enlightened shareholder value model – towards a stakeholder model? European Investors has been given to understand that the Code still embraces shareholder primacy,

but that the FRC intends to reflect the duties from Article 172 of the Companies Act in Principles A and C and thereby in the Code. Could this be confirmed? European Investors feels there should be no ambiguity and confusion on the Code's intended effects and consequences. This could create tensions between the board, shareholders and other stakeholders.

European Investors recommends the FRC to further explain Principles A and C to ensure openness on what is expected from directors. With regard to Principle A, it is unclear what "contributing to wider society" exactly is and how it should be applied in practice, especially in relation to generating value for shareholders which – according to the same principle - is a function of the board as well. Furthermore, Principle A states that the board should "establish the company's purpose, strategy and values, and satisfy itself that these and its culture are aligned". European Investors stresses it is unclear what "purpose" in practice could be or should and is of the opinion that adding this concept to the Code is of no added value. The Code already requires the board to establish the company's strategy and values which, in our view, should be sufficient in this regard. Moreover, UK law no longer requires the company to set its objectives. Consequently, we feel it is undesirable to revise the Code with a Principle which requires the board to establish a company's purpose.

## **2) Questions**

Below please find our answers to selected questions from the consultation document. We have focused on questions which, in our view, appear to have the greatest significance for investors.

### **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?**

European Investors welcomes Provision 6 of the Code which proposes companies to explain when announcing voting results, what actions they intend to take in order to the rationale behind any vote of more than 20 per cent against a resolution. An update should then be provided no more than six months after the AGM. The board should then provide a final summary in the annual report, or in the explanatory notes to resolutions at the next meeting on what impact the feedback from shareholders has had on the decisions the board has taken and any actions or resolutions now proposed.

European Investors supports the revisions as we expect these will increase transparency, encourage a meaningful dialogue with shareholders, improve accountability and help directors to focus on issues which a significant group of shareholders deem to be of particular interest to the company. European Investors agrees with the FRC that 20 per cent

is significant. It provides minority shareholders with an opportunity to raise concerns.

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

European Investors is satisfied that the FRC has carefully evaluated the criteria for non-executive directors to be considered independent. We agree with the FRC's focus on the issue of chairman tenure and further clarify the role of the chairman as an independent director.

In general, European Investors is supportive of the intentions behind the nine year tenure rule regarding independence. It will instil a moment of reflection and will lead boards and shareholders to consider whether a chair can still be deemed to be independent and able to remain in the post.

However, European Investors is concerned that the rule could be rigid and arbitrary in practice. We acknowledge that in some circumstances companies can opt to explain if they wish to retain a non-executive director or chairman after his or her term of nine years has ended. Yet, the tenure rule should not bring successful chairmanships to a premature conclusion or rule out very suitable candidates because they can only serve as a chair for a couple of years. Therefore, we recommend the FRC to review the effectiveness of the tenure rule, which is based on good intentions, in light of these concerns.

**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?**

European Investors is of the believe that boardroom diversity is an essential element in effective corporate governance. We agree that inclusive and diverse boards will improve decision-making and lead to better understanding of the markets and the wider world in which the company is operating. However, European Investors is also of the opinion that diversity in the board and in the executive pipeline should not only focus on gender, cognitive and personal strengths, cultural and social background, age, ethnicity and nationality, but increasingly on specific competences, especially in the boardroom where the strategic decisions are made. These specific competences should include knowledge and expertise with regard to IT, cybersecurity, ESG and finance.

We believe an increased focus on specific competences is of great importance for the future of companies because a confluence of disruptive trends challenges businesses in a wide variety of industries. These trends have the potential to dramatically change business models and the viability of companies as business environments become more volatile. In order to cope with these complex transitions, companies should focus on recruiting board members and senior managers who can provide answers to these challenges.

European Investors is of the opinion that companies should explain to investors how the composition of the board, in their view, is balanced, the points for improvement stemming

from performance evaluations and whether the company intends to recruit individuals with the necessary expertise when making future appointments. In our view, board effectiveness is about the richness and broader composition of the board as a whole.

**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?**

European Investors is of the opinion that long-term value creation should reflect in remuneration policies. We welcome the revisions to the Code which request remuneration committees to engage with employees and to oversee pay and incentives across the wider workforce. This should encourage greater focus on the strategic rationale for executive pay levels in a broader context. European Investors also welcomes that the FRC proposes to give the remuneration committees greater responsibility for demonstrating how pay and incentives align across the company and report on this matter in the annual report.

We are also supportive of Provision 37 which requires that remuneration schemes and policies include provisions which enable the company to recover and/or withhold sums or share awards, and specify the circumstances in which it would be appropriate to do so. This would enable boards to adjust remuneration outcomes; for example, where the measurement of any performance condition does not reflect the actual performance of the company over the period of performance of the individual director. In such cases, an adequate motivation for using this discretionary power should be provided in the annual report and the AGM.

Consequently, we expect that the wider remit will provide investors with meaningful information about pay ratios within a company, the level of workforce support for (executive) remuneration policies and how these remuneration policies will support value creation in the long term. European Investors is satisfied that the board has to engage with shareholders and report on the impact this has had on the remuneration policy and the outcomes. Most important is that the remuneration committee can explain to shareholders why remuneration policies are suitable.

However we recommend to expand Provision 41, which requires remuneration committees to explain through improved reporting standards what workforce engagement has taken place to explain how executive remuneration aligns with wider company pay policy, with an additional condition which demands companies to explain how they have calculated the pay ratio in their annual report (for example, on an international basis or per working area) and why their focus group is deemed to be representative.

In addition, European Investors wishes companies to include all relevant elements of the remuneration of directors, including the variable remuneration elements in calculations and explanations. We support Provision 32 calling for a fully independent remuneration committee with a chair that has served on a remuneration committee for at least 12 months. European Investors also welcomes Provision 36 which requires remuneration

schemes to promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests.

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

European Investors welcomes the Code revisions which seek to address concerns related to rising levels of pay and incentives which do not always support the long-term success of the company. Principle O ensures that the company remuneration policy does not only promote long-term success but also aligns with its strategy. Principle P specifically provides that performance-related elements of remuneration should be aligned to the successful delivery of the strategy. European Investors expects that both principles create a clearer link between the strategy of a company in relation to (long-term) performance and remuneration. Executive remuneration, especially the bonuses, should truly reflect company performance.

The FRC could be even more helpful to investors by adding a provision to the Code which reflects the aim of long-term value creation in any variable remuneration elements. A detailed explanation of the reasons for choosing these factors and the link between the variable remuneration element(s) and the goal of long-term value creation should also be provided. The company could further provide insight into the qualitative criteria that apply when awarding the variable remuneration (or part of it) in advance, and always after the evaluation period. Only this way can shareholders establish whether or not the remuneration policy is sufficiently challenging.

**3) Disruption, long-term resilience and reporting standards**

*Annual report*

Considering the impact of disruptive trends on companies and their business models (also see our answer to question 9), European Investors is of the opinion that companies should improve investor communications on these trends. The information in annual reports should be useful and not consist of boiler-plate or the provision of platitudes.

European Investors wants to ensure that market parties receive useful and relevant information which is tailored to the evolving economic reality and properly reflects not only the (material) risks but also the (material) opportunities on company's strategies and business models presented by disruptive trends, digitalization/IT/cyber security and (policies related to) climate change.

In order to make the Code more future-proof in this regard, we recommend the FRC to expand Provision 29 by requesting companies to provide for (a minimum of) three scenario analyses in the annual report which substantiate quantitatively the financial impact of a best, base and worst-case scenario. By complying with such a requirement, companies will capture the most relevant and principal risks posed by disruptive trends, the (potential)

impact of these risks and opportunities on the company's business, strategy and financial planning, and the way these risks and opportunities are assessed and managed by the board.

We believe that such a requirement would help to preserve sound investment decision-making in the UK and safeguard the stability of the economy and financial markets.

*Audit Committee*

In addition to the above, European Investors supports Provision 24 calling for 100 per cent audit committee independence.

**4) Concluding remarks**

Naturally, we would be more than willing to provide further written or verbal information in support of the above.

Yours sincerely,

Armand Kersten  
Head of Relations

Pieter Hanson  
Policy Advisor