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DATE 6 September 2018

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Dear Kristy

Proposed Wates Corporate Governance Principles and Guidance for Large Private Companies

We welcome the opportunity to respond to the FRC's Consultation on the proposed Wates Corporate Governance Principles and Guidance for Large Private Companies (the "Consultation"). In our view, the proposed Corporate Governance Principles (the "Principles") are high level enough to provide flexibility in the context of a wide variety of ownership structures and there are a number of benefits of using the Principles as a tool for engagement and improving governance practices. Some of the Principles bring in concepts which are also new for non-listed companies, for example, discussion around purpose and stakeholder engagement. There are, however, some aspects that require further consideration and our observations on the Principles are outlined below. In addition, we provide our responses to the Consultation questions in the Appendix.

Apply and explain

1. The proposed 'apply and explain' approach for the Principles is at odds with the ambition for the Principles to be as flexible as possible and to also appeal to companies not required by legislation to make a 'corporate governance statement'. Indeed, the application of an 'apply and explain' approach appears to be more onerous than the 'comply or explain' requirement in the UK Corporate Governance Code. As the Principles are new to large private companies, it is important to encourage their early adoption and application. In this regard, the FRC should foster a flexible approach and ensure that companies have time to adjust to the concepts and expectations of this new reporting obligation. In some cases, a company may not be able to 'apply' some of the Principles in the way expected due to a change in circumstances, such as owners exiting or winding down involvement where 'long-term success' may be difficult to articulate in the circumstances.

More emphasis needed on the role of the board in CEO oversight and succession planning

2. Sufficient focus on effective CEO oversight and succession planning is not drawn out in the Principles. Effective recruitment, retention and succession planning of the CEO is a key board role and for family-owned businesses, a focus on governance can also help with creating smooth

succession in terms of changes in ownership, whether the business ultimately stays in the family or is sold.

Lack of reference to reporting obligations

3. Another area insufficiently addressed in the Principles is the governance oversight of financial and other external reporting. Though it is mentioned briefly in the guidance, this important role of the board should be given greater prominence as private companies publish accounts, strategic reports and make other external statements required by legislation. Boards may be involved in this in a similar way to the 'fair, balanced and understandable' requirement in the UK Corporate Governance Code. Therefore, an explicit reference should be made to the board's role in oversight of the external auditor. Given the importance of this to stakeholders, it should be included in Principle Four.

Purpose and accountability

4. It would be useful for the guidance on the Principles to explicitly provide examples of those who would benefit from this reporting, including categories of stakeholders that might be the most important users. Given large private companies have not typically provided this type of information, they will need assistance in understanding expectations. In addition, it would be helpful to have guidance from the FRC as to how and by whom the FRC expects large private companies to be held to account for statements made when reporting on their application of the Principles. In the Guidance to Principle One, reference could be made to encouraging consideration by the board of whether the board believes its membership is suitable for delivering the company's stated purpose.

Clarity needed on references to 'employees' and 'workforce'

5. Large private companies have obligations to provide a strategic report under the Companies Act 2006, which refers to information about the company's 'employees'. However, the Principles refer to 'workforce' and in some cases 'wider workforce' without providing the definition of either of these. This could be confusing to companies and should be clarified in guidance to the Principles. Otherwise, the reporting obligations could become more complex and burdensome. The Principles should expressly acknowledge the difference between these terms and explain how companies should interpret references to 'workforce', such as how it is referred to in the Guidance on Board Effectiveness 2018.

Review the operation of the Principles

6. The FRC should monitor the Principles in order to understand how companies are applying them and assess if changes are needed. Given the Principles will be new, it would be helpful for the FRC to publish guidance on the Principles, once they have been in circulation for a couple of years and they have observed them in practice. The FRC could also conduct a review periodically of the

corporate governance practices of large private companies, which could follow a similar approach to that which the FRC uses for quoted companies and the UK Corporate Governance Code.

In conclusion, we support the overall approach to the introduction of these Principles for large private companies, but subject to the suggestions we have made here. Given the application of the Principles is due to commence for financial years starting on or after 1 January, 2019, it is important to ensure the final version is published in a timely manner to ensure companies have time to implement them in the true spirit of good governance. Given the new requirements will apply for the whole of the financial year, there is already a serious risk that companies will not be well positioned to provide meaningful information in the first year of operation. The FRC should specifically acknowledge this when it issues the final Principles, so that stakeholders are on notice that expectations in the first year are not as high as might be expected in subsequent years.

I would be very pleased to engage with you further on this important consultation. Please feel free to contact me if you have any questions on the points raised in this letter or you would like to discuss other matters related to the Principles.

Yours sincerely

Eamonn McGrath
Partner, UK Head of Regulatory & Public Policy

Appendix 1

Responses to Questions Raised in the Consultation

Question	Response
<p>1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?</p>	<p>No, the Principles do not address all of the key issues. Specifically:</p> <ul style="list-style-type: none"> • Note our comments in paragraphs 2 and 3 of our letter on reporting and oversight. • Given that there is a requirement for companies to publish a strategic report, it seems surprising that the Principles do not cover this matter in more detail or cross reference this. • Even though these are private companies, the value of having independent thought and challenge on the board (or outside sources) should be referenced.
<p>2. Are there any areas in which the principles need to be more specific?</p>	<p>Yes. Given the broad range of entities that will be covered by the Principles, many areas will need to remain less prescriptive. All of the Principles convey straightforward messages and reflect a common sense approach to corporate governance. However, please note our comments in paragraphs 2 to 5 of our letter regarding specific improvements that should be made.</p> <p>As noted in paragraph 6 of our letter, it would be helpful for the FRC to publish guidance on the Principles, once they have been in circulation for a couple of years and they have observed them in practice.</p>
<p>3. Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?</p>	<p>No, the Principles do not take sufficient account of different ownership structures.</p> <p>For example, insufficient account is taken of private equity owned companies, especially where Principle Four refers to boards having to take account of the long-term success of the business. There may be circumstances where considerations that might appear to conflict with a long-term focus can apply, e.g. where owners are exiting or winding down involvement. The guidance on Principle Four should make it clear that any explanation may need to include how these short term considerations are in the long term interests of the company.</p> <p>Although the Principles can be used by subsidiaries of large group companies (UK or overseas) to fulfil their reporting obligations, it is important to acknowledge that in the case of subsidiaries, there may be considerable constraints on their capacity to act, for example, on appointment of a CEO or in undertaking reporting obligations. The guidance to the Principles could suggest that</p>

	<p>companies explain these constraints and how they affect the governance of the subsidiary.</p> <p>The Principles have not addressed the need for boards to consider the use of non-executive directors (or other outside sources), as a means to help counter decisions/behaviour that could be harmful for some stakeholders.</p> <p>Principle Six refers to stakeholder engagement and that companies should have regard to this engagement when making decisions. Whilst supporting the importance of engagement, the guidance on Principle Six should expressly acknowledge that some information may need to be withheld due to commercial sensitivities (or personal matters in the case of a family owned business).</p>
<p>4. Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors' remuneration?</p>	<p>Yes.</p> <p>Reference is made to long-term value in the context of remuneration structures. However, the level of interest in directors' remuneration will be completely different depending on ownership structures. For example, a private equity company would look at it through one lens, whereas a subsidiary would have a very different perspective. This should be expressly acknowledged.</p> <p>There is a need for more detail in Principle Five in terms of what 'promoting' and 'aligning' means in this context. Their use is unclear.</p>
<p>5. Should the Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?</p>	<p>No, because the first priority should be to encourage companies to identify their stakeholders, and consider which categories matter more than others. It also depends on how much information is disclosed, particularly given commercial sensitivities (or personal matters in the case of a family owned business). If key material stakeholders are identified and impacted, it should not be harmful for companies to disclose this, even in a subsidiary situation if the impact is at the entity level.</p> <p>This is an area which could be reviewed by the FRC after a few years of practice to see how companies have put stakeholder engagement into practice.</p>
<p>6. Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?</p>	<p>Yes.</p>
<p>7. Do you agree with an 'apply and explain'</p>	<p>No. See paragraph 1 of our letter.</p>

<p>approach to reporting against the Principles? If not, what is a more suitable method of reporting?</p>	
<p>8. The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?</p>	<p>See paragraph 6 of our letter.</p>
<p>9. Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?</p>	<p>Yes, so long as the Principles retain their approach of looking at high level issues. However, we reiterate our concerns on the 'apply and explain' approach expressed in paragraph 1 of our letter.</p>
<p>10. We welcome any commentary on relevant issues not raised in the questions above?</p>	<p>We have nothing further to add.</p>

- END OF RESPONSE -