

Submission from Fidelity International in response to the Financial Reporting Council's Proposed Revisions to the UK Corporate Governance Code

We are pleased to have this opportunity to respond to your consultation on proposed revisions to the UK Corporate Governance Code (“the Code”). Fidelity International (“Fidelity”) has £239 billion of assets under management with approximately £20 billion invested in UK listed equities and with almost all of these funds being under active rather than passive investment mandates.

Introduction

As an overall observation we are supportive of the move to update the Code but we think it is important that both the Code and the Stewardship Code retain a high level perspective and do not become too directive or centred around specific governance themes. There are numerous critical issues for shareholders to consider but there is a risk that by naming some of these issues attention may be diverted from other unnamed but worthwhile matters. Furthermore, the most critical governance issues will differ between companies.

We also recognise that the scope of corporate governance has expanded in recent years but we nonetheless think that the Code should continue to emphasise the absolute and overriding importance of boards promoting the long-term, sustainable success of companies. This is highlighted in the opening words of Principle A but Principle A then goes on to say that companies need to contribute to wider society and that boards need to satisfy themselves that company culture is aligned with purpose, strategy and values. We don't disagree with the notion that companies need to contribute to wider society but do not believe this should be mandated in the Code and we would prefer the opening words of the Code to concentrate on the primary purpose of companies and indirectly the primary purpose of the Code itself. One possibility would be to restrict Principle A to the simple and straightforward wording that *“A successful company is led by an effective and entrepreneurial board, whose function is to promote the long-term sustainable success of the company.”*

We have not endeavoured to answer all of the questions in the consultation but only those on which we hold a definitive view.

Question 2 -- Do you have any comments on the revised Guidance?

We agree with your decision to transfer many of the supporting principles of the Code to the expanded text on Guidance on Board Effectiveness (“the Guidance”). However, we note that the Guidance is not subject to the same comply or explain requirements as the Code and hence does not carry the same weight and we question whether some of the more important elements of the Guidance should not be subject to the higher standards of the Code itself, with non-compliance requiring explanation.

There are three particular points which have been transferred to the Guidance and which we would draw to your attention. Firstly, we regard Provision A.4.1. of the existing Code which provides for the appointment of a senior independent director and for this senior independent director to be available to shareholders if other normal channels of communication are deemed to be inappropriate, as a key measure of shareholder protection and one which companies most definitely should observe. Secondly, we would highlight Provision E.2.3 of the existing Code under which the chairman should arrange for the chairmen of the audit, remuneration and nomination committee to be available to answer questions at the AGM and for all of the directors to attend the AGM. Once again, we regard this Provision as being a core element of good practice. Finally, we would highlight the Supporting Principle under Section B.1 of the existing Code under which no one other than the committee chairmen and members are entitled to be present at meetings of the nomination, audit or remuneration committees other than by specific invitation. All of these are measures where any non-compliance should, in our opinion, require an explanation.

Paragraphs 69 to 74 of the Guidance provide important definition to the role of the company secretary. The company secretary is the only corporate officer who is exclusively dedicated to the board and in our view performs a critical governance function. We believe there is wide divergence in how different companies define the company secretarial role but would recommend a guideline to the effect that larger companies should be expected to treat the company secretary's position as a position in its own right and separate from other corporate functions such as investor relation or legal affairs. This would also be consistent with Recommendation 2 of the 2009 Walker Review on corporate governance in UK banks and other financial industry entities and which stressed the importance boards providing dedicated support for non-executive directors on any matter relating to the business.

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

We believe that any of the three alternative methods described in Provision 3 for gathering the views of the workforce could be effective but would suggest that Provision 3 also allow for the possibility that there may also be other mechanisms which achieve this objective. The obligation upon the board is clear but there should be more flexibility allowed in how the obligation is fulfilled.

Question 4 -- 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?

We are supportive of the United Nations' Sustainability Development Goals ("SDG") but do not believe that the Code should refer to any specific third party guidelines. Not only are best practice guidelines continually evolving but by making reference to specific sets of guidelines there is a risk that other unnamed guidelines are overlooked or subordinated.

Question 7 -- Do you agree than nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

In general we agree with your view that non-executive directors should no longer be regarded as independent once they have served on a board for nine years but we are concerned about the proposal to extend this guideline to include chairmen as well. This will most likely shorten the tenure of chairmen and may also inadvertently encourage companies to appoint external rather than internal candidates to become chairman and this may not always be in the company's best long term interest. A possible compromise might be to allow chairmen to have a total board tenure of up to twelve years before they are deemed to be non-independent. A twelve year tenure under these circumstances would be in line with practice in many continental European countries as well as in line with the recommendations of the European Commission.

Question 8 -- Do you agree that it is not necessary to provide for a maximum period of tenure?

We do not favour defining a maximum period of tenure for directors. Best practice has developed around a period of nine years being a sensible limit and we support this, but we are keen to allow companies the flexibility to retain directors for longer periods when they feel this is warranted. A formal Code recommendation of a nine year limit would reduce this flexibility. There may even be merit in considering introducing a recommendation that at least one of the non-executive directors should have served on the board for longer than the Chief Executive but we recognise this may represent too radical a departure from current practice for you to adopt at this point.

Question 9 -- 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 are fully supportive of the objective of building greater diversity in the boardroom and Principle J helpfully encourages the promotion of diversity of gender, social and ethnic backgrounds, cognitive and personal strengths. Principle J also stresses the importance of merit and objective criteria in making appointments and determining succession plans. We believe merit is an absolutely critical determinant and would suggest that the second sentence of Principle J should be amended to read as follows :- *“Both appointments and succession plans should be based on merit and objective criteria, and within this context appointments and succession plans should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.”* Boards need to reflect the social environment in which they operate but their primary duty is to promote the success of the company and this should be prioritised at all times.

Paragraph 23 sets out guidelines on how the annual report should describe the work of the nomination committee and suggests that the annual report include a description of how board evaluation has been conducted, detailing the outcomes, actions taken and how it has influenced board composition. We accept that information should be provided on board evaluations but question the level of detail which should be shared in public. We have always supported the concept of board evaluations (particularly external effectiveness evaluations) but believe the primary purpose of these evaluations is to help boards themselves

become more effective. If too much information has to be made public then it fundamentally changes the nature of the exercise and reduces the value of the evaluation to the board. Yes, shareholders need to be informed that a board evaluation has taken place but it is important that the process does not become a box ticking exercise and we would therefore favour a qualification on the amount of public disclosure required.

Question 15 -- Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

The underlying purpose of management incentive schemes is to align the interests of management with those of the shareholders and we believe one of the most effective ways of achieving this is to require awards to be retained for a period of time. In this context we are fully supportive of the proposed new Code recommendation that shares granted under long term incentive schemes should be subject to a vesting and holding period of at least five years.

Question 22 -- 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 specific areas of focus that should be addressed?

As stated in the introduction we would prefer both the Code and the Stewardship Code to retain a high level perspective and not to mandate specific topics for engagement. In particular, we do not think it would be appropriate to give shareholders a specific duty to monitor and engage with companies on how they interact with wider stakeholders. This comes close to giving shareholders obligations to other stakeholders which we think would be very difficult to fulfil in practice.

Question 25 -- Are there elements of international stewardship codes that should be included in the Stewardship Code?

The 2012 version of the Stewardship Code includes guidance that institutional investors should disclose their approach to stock lending and recalling lent stock. Various international stewardship codes require more detailed disclosure around stock lending, and given that stock lending almost invariably involves the loss of the right to vote we believe that more detailed disclosure requirements around this important activity would be appropriate.

Question 26 -- What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

We do not believe that the requirement to obtain independent assurance on engagement and voting practices is beneficial. Our experience to date is that the external assurance process

has not added any significant value to our engagement or voting practices and there are even restrictions on the ability to use the external assurance reports for client reporting purposes. As an alternative we would suggest that the Stewardship Code recognise the potential for the internal audit function to replace an external assurance process.

Questions 28/29 -- Should board and pipeline diversity be included as an explicit expectation of investor engagement? Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

We repeat the points which we raised in the introduction to this submission and to the answer we gave in response to Question 4. There are numerous critical corporate governance issues for shareholders to cover in their dialogue with investee companies and the most important issues will differ between different companies. We believe that like the Code, the Stewardship Code should retain a high level perspective and not become too drawn on individual topics as there is a risk that by identifying certain specific issues, other unnamed but important matters will receive less attention than would otherwise be the case.

We hope that this submission will make a positive contribution to your deliberations but please feel free to contact us if you have any questions.

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