Financial Reporting Council

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The Future of Governance

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18:30 – 20:30

Good evening,

I am pleased to have been asked to speak about the future of governance. The Institute of Chartered Secretaries & Administrators have been instrumental in embedding the principles and practices of sound corporate governance in the UK. It is important that the Financial Reporting Council and ICSA work together to influence and enhance these governance practices. We will hear from Chris Hodge about how the demands on our framework of corporate governance are growing. We expect it to create an environment that not only fosters investment in the UK economy but promotes trust in business to benefit all of society. With Brexit looming, the need to maintain the flow of global capital into UK Companies is ever more important. Good, globally respected corporate governance plays a significant role in attracting that flow of capital to the UK. Effective but proportionate regulation, will guide our priorities over the next year.

The UK Corporate Governance Code is 25 years old this year. It is respected worldwide – yet, trust in business continues to decline. In January, Edelman released its annual Trust Barometer which shows that we are experiencing a calamitous collapse in trust in many of the institutions that shape our society. Trust in the UK is at a historic low on the Barometer, at 29 per cent. Attitudes to institutions are no longer defined by left, right or centre, but by a political realignment around those who have “faith in the system” and those who don’t. Business is not quite at the bottom but at 33 per cent, it needs to engage and demonstrate that it is part of the solution rather than the cause of public concerns.

Since the financial crisis, the FRC has taken some important actions to improve confidence in the way companies are governed. They include long-term viability statements, improved risk reporting and greater focus on boardroom diversity. Last year, our report on corporate culture highlighted the board's role in shaping, embedding and assessing corporate behaviours and culture.

It also demonstrated that there is more to do. Unfortunately, we still see examples of poor behaviour, for example, in BHS and Sports Direct. We must make sure that the strength of international investor confidence in UK Corporate Governance continues to be recognised, particularly in times of economic uncertainty. While many of us recognise that wealth creation has disproportionately favoured some sections of society, I suggest that this is not a new phenomenon. What is different this time?

The Prime Minister has a vision of an economy that, in her words, "works for everyone", but needs UK businesses to thrive so that all stakeholders including workers, customers, suppliers and society itself benefit through jobs growth and prosperity.

With all this in mind, prior to public consultation later this year, we will conduct a review of the current UK Corporate Governance Code. This will consider the appropriate balance between the Code's principles, provisions and guidance. In pursuing any changes, the current strengths of UK governance, the unitary board, strong shareholder rights, the role of stewardship and the "comply or explain" approach, must be preserved we believe. We must not throw out the baby with the bathwater.

Any changes to the regulatory frameworks and to the Code will be done carefully and through full consultation with a wide range of stakeholders. We have established a Stakeholder Advisory Panel with high profile representatives from a range of sectors so we can gain insights to inform our decisions. It is worth noting that, if anything, the bias in the US is towards de-regulation and we in Europe and the rest of the world will need to be mindful of that.

Finally, corporate culture. We are indebted to a coalition of five partners who helped us produce our report “Corporate Culture and the Role of Boards” in July. I should like to use this occasion to thank the CIPD, CIMA, the IBE, the CIIA and the City Values Forum, for their work.

Our report sets out a number of key observations and examples of best practice. In particular, it encourages Boards to:

- **Recognise the value of culture:** A healthy corporate culture is a valuable asset, and a source of competitive advantage. It creates and protects long-term value. The board should determine the purpose of the company and ensure that its values, strategy and business model are aligned. Directors should not wait for a crisis before they focus on culture.

- **Demonstrate Leadership:** Leaders, in particular the chief executive, must embody the desired culture, embedding this at all levels and in every aspect of the business. Boards have a responsibility to act when leaders do not deliver. Remuneration must be consistent with the desired culture. This applies as much to when appointments are made, as to the quantum of incentives and importantly disincentives over their career.

- **Be Open and Accountable:** Openness and accountability matter. Good governance means a focus on how this takes place throughout the company. It should be demonstrated in the way the company conducts business and engages with and reports to stakeholders, and it involves respecting a wide range of stakeholder interests.

- **Measure what is actually happening:** Metrics should be tailored to behaviours and include external as well as internal stakeholder views.

Increasingly investors have recognised the importance of culture and are asking questions about it in their stewardship meetings with company chairmen. Reporting on culture while currently limited, is clearly an area of increasing importance, I am happy to observe.

So, my Lords, ladies and gentlemen, I hope I have given you an insight into the FRC's vision and concerns on corporate governance. Values, behaviours and corporate culture are central to the way an organisation achieves its objectives and embeds an effective governance structure. By weaving these attributes into a business model, companies are not just contributing to the overall success of their business but, creating an environment on which all stakeholders can depend. And in that way they create sustained growth for the long-term.

Let me close by reiterating my thanks to ICSA and my old colleague Chris Hodge, for their thought - provoking paper on the future of governance which has been the genesis of this evening's discussion.

Thank you.