

RESPONSE TO THE FRC CONSULTATION ON CHANGES TO THE UK CORPORATE GOVERNANCE CODE

Please find below my response to the UK Corporate Governance Code consultation. The views expressed below are my own, they are not necessarily those of any other organisation where I hold office.

I write from the perspective of a governance professional with many years' experience and of a non-executive director. I currently work primarily with smaller companies, although I have also worked in FTSE 100 entities.

Lorraine Young BSc FCIS

General observations

Although the Code is targeted mostly at companies listed on the main market and is supposed to be adopted on a "comply or explain" basis, in practice many of the bodies which analyse company reporting in this area continue to adopt a "tick box" approach. I cannot see this changing, all the while there remains pressure on resourcing. Therefore, I support as much flexibility for companies as possible, within an overarching governance framework. The more prescriptive the Code is, the more difficult it is for companies to adapt the requirements to their own needs. Of course, this should not result in lax governance.

This is particularly important for smaller companies. I have worked in the FTSE100 and with some very small AIM listed entities. There is a continuing push for smaller companies to do more on governance. While this is not a bad thing in itself, there is concern that the burden and costs to comply will be out of step with the benefits brought. For those companies which are smaller and growing, the current environment which allows them to develop their governance processes as they grow is welcome. Recent changes to the AIM rules are bringing more pressure to bear on AIM listed companies as they will soon have to explain how they comply with the governance code they choose to adopt. It is to be hoped that investors will continue to be flexible in their approach to smaller company governance, despite the rule changes. One size does not fit all.

I agree that **all** companies should strive for **good** corporate governance, I do not believe that "*even smaller companies should strive for the highest standards of corporate governance*" as suggested in paragraph 48 of the consultation. What is appropriate for a large, international organisation in the FTSE100 will often not be at all appropriate or relevant for smaller companies and these standards should not be imposed automatically. Governance is a journey and companies should be allowed to evolve their governance at an appropriate pace.

I therefore do not support the proposals to remove the exemptions for smaller companies in terms of board and committee composition and board evaluation. This would mean that many companies which have complied with the Code for years because of the exemptions, would suddenly find that they don't comply even though they are not doing anything differently. I cannot see that this benefits anyone.

Response to consultation questions on the Code and Guidance

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?

I welcome the approach to remove many of the details on systems and procedures from the Code and include these in the Guidance. This is a helpful way to “de-clutter” the Code.

However, this means that the Guidance itself is quite long. As a governance professional I will read and re-read it. If it could be made shorter, without losing its key points, then I believe it would reach a wider audience.

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

I agree that there should be a choice of methods to pass on the views of employees to the board and I support those suggested in the consultation. I also support what is stated in paragraph 35 of the Guidance that companies should be able to determine the best way for them to achieve the overarching aim of representing the “employee/workforce voice” at board level and the recognition that there might be other ways to do this than the three options specifically referred to. This should be made clearer in provision 3 of the Code.

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?

No, I think the proposed wording in Principles A and C, and provision 4 is sufficient. I support the proposal to ensure that provision 4 reflects any changes to company law in this area.

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?

The figure of 20 per cent appears to have been adopted by several investors and companies as the appropriate level to judge what is significant dissent. This seems reasonable. There is not complete agreement on whether “dissent” is simply votes against or whether votes withheld should be included. I would not support including votes withheld when calculating this figure. It should be 20 per cent of the votes cast and votes withheld are not votes cast. The vote withheld option has come to be viewed by investors and companies as a “warning shot” by investors, with a vote against/dissent following on the next year if no action is taken to address the concern. Most companies would engage with any investor which registered a large withheld vote in order to understand their concern. Certain parts of the media often take a different view and seek to imply that the vote withheld is an against vote, which it is not.

It would seem to be good practice to publish an update within six months after the vote, even if the matter was not completely resolved by then.

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

I do not agree with this. I work with many small companies and they would not wish to spend the money necessary to carry out a “proper” board effectiveness review. They would probably use a questionnaire and it would end up as a tick box exercise of limited use. This then risks devaluing board effectiveness reviews overall.

I would prefer to see this remain as an option for smaller companies – as they grow it should be considered best practice for them to carry out a review. Many companies may begin board evaluations with questionnaires but they should move on to a much more in-depth exercise over time if the review is to achieve the outcome for which it was intended.

I believe the exemption should remain in place.

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

In provision 15, the proposed new Code is more prescriptive in its stance on independence, as it states that NEDs **should not** be considered independent if they fall under one of the points listed. Previously this was a matter for board discretion. I believe it should remain so and I do not support the more prescriptive approach proposed (see my general observations above).

On the individual points in the list, in relation to the nine year term, I believe that nine years is a useful guide for NEDs’ independence but I don’t believe it should be cast in stone.

In its corporate governance policy and voting guidelines for 2018, the Pensions and Lifetime Savings Association says:

“The value of the tenure guideline of nine years is to drive refreshment of the board overall rather than marking a limit on the value offered by an individual. With increasing tenures directors will be subject to increasing scrutiny as to their effectiveness and independence. Most importantly boards should set out their forward looking succession and refreshment plans in detail when they propose the re-election of a long-serving non-executive director, especially when the director is chairing an important board committee.”

“When the director is an independent non-executive proposed for re-election beyond nine years, a particularly rigorous review and evaluation process is to be expected.”

And

“Where a director has served for over nine years concurrently with an executive director, that director should no longer be deemed to be independent. He/she should therefore no longer serve on those committees which should consist solely of independent directors.”

These are helpful and more pragmatic views than the proposed new wording.

In relation to the chair I do not support the suggestion that the nine year rule should be applied to the whole of their term on the board. A director may serve on a board for a number of years before becoming chair. If the nine year rule is then applied to their total term it could result in unnecessary difficulties, particularly in the way it has been expressed in paragraph 54 of the consultation (I do not agree with the views expressed in this paragraph). There should be adequate succession planning and rigorous review, with some flexibility.

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

Yes, I agree. This should be a matter for the board as it undertakes succession planning. The principal issue is to ensure regular refreshing and that the board continues to have the skills and experience which are needed to enable the company to succeed in a sustainable way.

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?

I agree that still more needs to be done to improve both gender and ethnic diversity in organisations. The changes proposed in section 3 should assist. I could not comment on whether they **will** lead to more action in this area. The work of nominations committees can often be neglected as they are supposed to deal with the “softer” and more difficult “people” issues. Therefore, any attempt to improve the situation is welcome.

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. It appears to me that this should not involve a lot of effort or cost. Asking all companies to report in this area should help to drive improvement.

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.

In theory this sounds like a good idea, however, there may be practical obstacles, particularly for larger organisations. It is not always possible or permitted to ask people to disclose their ethnicity. Therefore, any change in this area should suggest increased disclosure as an option, not a requirement.

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, I agree.

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, I think this is appropriate.

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?

I agree that it would likely benefit remuneration committees to be able to take a more holistic, organisation-wide approach when determining executive pay and to have a better understanding of the overall context in which its decisions are made. Remuneration committees have been tasked with taking account of “the wider scene” for some time. I would support remuneration committees overseeing pay and incentives across the wider workforce.

However, in terms of overseeing other workforce policies and practices, this could get too operational. Care would be needed to ensure that the remuneration committee was not being asked to perform an executive function.

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

No. Provisions 36, 37 and 40 are helpful in this regard.

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

The wording in principle Q should assist boards and remuneration committees in exercising discretion in situations such as Persimmon. Provision Q should refer to “remuneration committees” either instead of or as well as “boards” exercising discretion as sometimes these decisions will be within the remit of the committee for the reason that the executive directors should not be involved in decisions affecting their own pay.

Comments on other points which are not covered by the consultation questions:

Provision 10

In relation to provision 10, I do not agree with the implication in the current draft of the Code that the Chief Executive should be solely responsible for ensuring timely and balanced information is presented to the board. I prefer the wording in the supporting principle under B5 of the current version of the Code, which states that “the chair is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information.....”

It is the role of the chair to run the board and therefore the chair should have the responsibility to ensure that management deliver what is needed. This is in fact picked up in paragraph 50 of the

Guidance, but it should also be reflected in the Code itself. Paragraph 63 of the Guidance refers to the chief executive's responsibilities in this area.

I would suggest either removing the reference to the CEO having this responsibility in the Code and leaving the references in the Guidance or including a reference to the responsibilities of both chair and CEO in the Code.

I note the references to principle H and provision 16 but this does not alter my view.

Provision 11 – I support the concept that the chair is to be considered independent at all times. This is a notable change from the current position. It is helpful - and in many cases reflects reality. I understand that in some circumstances it may not be appropriate but in such cases, the board will be able to indicate that they have reached an alternative conclusion and why they have done so.

As noted in my opening comments, I do not support the removal of the wording in current Code provision B.1.2 for smaller companies to have at least two independent non-executive directors, rather than having to have the majority of the board as independent directors. For some smaller companies having two independent NEDs should be sufficient and this should be kept under review as the company grows. The benefits of having additional independent NEDs need to outweigh the costs. If the flexibility is not retained it will become a matter for box ticking.

Section 4 – audit, risk and internal control

This appears to be little changed. I think it works well and I have no comments.

Provision 32

Providing the wording remains that a remuneration committee chair should have served on "a" remuneration committee for twelve months before taking office as chair of one, then I would support this. I would not support a proposal that any remuneration committee chair should have been on that particular remuneration committee for twelve months before becoming chair as they may have valuable experience elsewhere. So, I support this provision as currently drafted.

28 February 2018