



Catherine Woods
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

Date: 27 June 2014

Dear Catherine,

Re: Consultation on changes to the UK Corporate Governance Code

We are responding on behalf of Aviva Investors. Aviva Investors is the global asset management business of Aviva plc. The business delivers investment management solutions, services and client-driven performance to clients worldwide. We operate in 14 countries in Asia Pacific, Europe, North America and the United Kingdom and have assets under management of £246bn at September 2013.

Overall, we are supportive of the amendments being proposed to the UK Corporate Governance Code and the direction of travel. We are especially supportive of the focus of remuneration plans on the long term success of business. In parallel, we are supportive of the Association of British Insurer's stance on Going Concern.

However, we are disappointed that there continues to be very little on culture, ethics and the wider integration of sustainability into governance despite our previous submissions to the FRC.

Corporate governance is the overarching structure under which everything else falls – competitiveness, strategy, performance, capital budgeting, operations and sustainability. We commend to you the recently released UNEP FI report called *Integrated Governance: A new model of governance for sustainability* which builds on the concept of integrated governance. This is available at <http://bit.ly/1kXm4HI> which provides the evidence that is building on the link between sustainability and performance. In view of the over 200 academic reports that show a statistically significant relationship between sustainability performance and financial performance, the increasing number of sell-side financial reports covering sustainability issues, the increasing number of asset managers that now integrate sustainability issues into corporate governance, and the disaster of the latest financial crisis which, in large part, was the result of poor ethics, the UK Corporate Governance Code now appears behind the times and the market is moving faster and beyond the Code.

To be clear, our understanding of *Integrated Corporate Governance* is a corporate arrangement that ensures the guiding mind of the company (ie the board) gives consideration to long-term sustainable development, risk and opportunities. To expand on how sustainable development issues can be integrated into corporate governance, it is the role of the board to

- (i) ensure that the standards and values of the firm are set, understood and well met. These standards should include material sustainability issues.

- (ii) The board also sets the company strategy, which should integrate sustainability issues.
- (iii) Similarly, they should set, monitor and report on key performance indicators for material sustainability issues
- (iv) In addition the board should nominate an executive director to be responsible for leading the company's sustainability strategy, setting up a board sub-committee where appropriate. If an alternative model is chosen it should be clear who takes ownership of the sustainability strategy.
- (v) Given our previous submissions on remuneration to the FRC it is fair to say that we are both of the view that incentives matter. With this in mind the board should integrate sustainability performance into the balanced score cards of board members and the senior management, including performance related pay, where they are material and measurable.
- (vi) They should also ensure sustainability and board diversity is integrated into board succession planning and training in order to ensure that a culture promoting sustainable business practices pervades the firm

In view of the very public misdemeanours of a variety of listed companies spanning many sectors and the need to restore trust in business, we would have thought this was an opportune time to re-emphasise in more detail the behavioural aspects of governance especially since bad behaviour has been costly to investors over the last few years. If not now, when would be a better time to focus on this? In our view, it is the culture of a company, not just the rules and regulations and processes that is required for effective risk management. Arguably an ethical culture is the most effective barrier to bad behaviour albeit we appreciate cultural changes cannot happen in a vacuum or overnight.

We would be delighted to discuss our submission further. Please contact my colleague Abigail Herron, Head of Responsible Investment Engagement, in the first instance at Abigail.herron@avivainvestors.com

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Steve Waygood', with a horizontal line underneath.

Steve Waygood

Chief Responsible Investment Officer
Aviva Investors

Questions for Consultation

Question 1: Do you agree with the proposed changes in Section D of the Code?

Yes. We are supportive of the proposed changes and consider the new wording reinforces best practice. In particular we welcome the introduction for pay to be designed to promote the long-term success of the company. It is also important that conflicts of interest are managed and this section could be strengthened by asking for disclosure of the nature of the conflict and from whom.

Question 2: Do you agree with the proposed changes relating to clawback arrangements?

We are supportive of the introduction of the wording relating to clawback in the Code. However, we believe clawback should apply in broader circumstances than where accounts have to be restated. Therefore, the Code should require Committees to disclose the circumstances in which these provisions could be used, but not prescribe specific circumstances so as to leave some discretion for the Remuneration Committee. In addition to this we are comfortable with the Remuneration Committee retaining the flexibility to self determine where a clawback is practically implementable. The remuneration committee should review the circumstances in which these provisions can apply and ensure that they are appropriate for the company on an ongoing basis. The time horizons for the clawback should be included in the description of the claw back procedures.

Question 3: Do you agree with the proposed change relating to AGM results? Is the intention of the proposed wording sufficiently clear?

Yes. We welcome the introduction of this provision. However, we strongly believe that it is appropriate that it applies to all ordinary and special general meeting resolutions and not solely remuneration-related resolutions. Singling out remuneration resolutions for special attention in the Code would give a signal that by comparison engagement on strategy, board composition and other matters of significance to shareholders were not a priority. This will ensure that all AGM resolutions are considered equally and that remuneration-related resolutions do not overshadow the other provisions of the Code.

We believe that it should be common sense and good practice to engage with shareholders on any issues, in particular where a significant proportion of shareholders have voted against a resolution at a general meeting.

We suggest that the Code includes a specific reference to the GC100 and Investor Group guidance on this issue.¹ The guidance was carefully considered by companies and investors and we place great credence in it. In addition, companies should include in their statement a reference to a time commitment regarding the action they propose to take.

This will assist shareholders greatly in holding the Board accountable for the actions which they have committed to take.

Question 4: Do you agree with the proposed amendments to the Schedule?

Yes. We support the proposed changes to the Schedule. Our only reservation concerns the fourth paragraph of Schedule A;

“The remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise of an option, including for a period after leaving the company, subject to the need to finance any costs of acquisition and

¹ <http://uk.practicallaw.com/groups/uk-gc100-investor-group>

associated tax liabilities. In normal circumstances, shares granted or other forms of deferred remuneration should not vest or be paid, and options should not be exercisable, in less than three years. Longer periods may be appropriate."

There may be personal tax implication in some jurisdictions, for instance in France, in requiring directors to retain their shares after resignation. We encourage further research on the practical implications, given the growing diversity of board directors in UK plcs.

Question 5: Do you agree with the changes to the Code relating to principal risks and monitoring the risk management system?

We are pleased that the FRC sees the words 'significant' and 'principal' as inter-changeable. However, many investors see principal risks as more restrictive and there is concern over how companies will interpret 'principal' risks. It is not worth creating mistrust for the sake of keeping the words consistent between the Code and the requirements of the Strategic Report.

Question 6: Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?

Yes, we believe this is helpful

However, on balance, we would prefer the use of 'foreseeable future' rather than the latest wording in the proposed C.1.3 referring to a period 'of at least twelve months from the date of approval of the financial statements'. As we understand it the combination of "foreseeable future" with "high level of confidence" was a sticking point for many respondents to the previous iteration of this consultation. As 'high degree of confidence' has now been replaced by 'reasonable expectation' we would prefer 'foreseeable future' as a broader, more flexible and, depending on how companies approach this, will become a basis for engagement. Otherwise, we can see companies defaulting to using 12 months in its assessment of going concern.

We are aware that there are ongoing discussions around 'foreseeable business period' which we believe has the potential of being the most meaningful of all the alternatives as it puts the emphasis on the Board to explain why a certain period was foreseeable in the context of the entity, its operational environment and business cycle. We would encourage the FRC to consider this approach.

We also agree with the ABI view that the assessment scope should not be limited to principal risks only but, rather, first be drawn widely to take account of the overall state of affairs of the Company and, only then, be more narrowly considered in relation to the principal risks. While the proposed inclusion of "current position" represents an improvement, it does not reflect the discussed sequence and is a concept less understood by Directors compared to the "state of affairs of the Company". The latter is also a concept linked to the requirement to provide a true and fair view as of the balance sheet date, which is considered important so as to ensure a link to the risk of balance sheet insolvency.

Question 7: Do you agree with the way proposed Provision C.2.2 addresses the issues of the basis of the assessment, the time period it covers and the degree of certainty attached?

The proposed Provision C.2.2. does address the issue of the basis of assessment, the time period it covers and the degree of certainty attached and we support the introduction of this additional statement. Please also see our answer to Q6 above.

Question 8: Do you have any comments on the draft guidance in Appendix B on the going concern basis of accounting and / or the viability statement?

No comment

Question 9: Should the FRC provide further guidance on the location of the viability statement?

It would make sense for the viability statement to be included in the Strategic Report and we agree that the FRC should discuss with the FCA whether it is appropriate for the Listing Rules to be updated to reflect this and to prevent duplication. We would like the requirements to be clear so that all companies report in a consistent way.

Question 10: Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?

Yes and yes. Our one caveat would be that some issues will be confidential and cannot be publically reported, for instance, legal remedies, Serious Fraud Office investigations or the Organisation for Economic Co-operation and Development (OECD) driven UK National Contact Points (NCPs), mediation. Further guidance on this would be helpful.

Question 11: Should the option of giving companies the possibility of putting the full corporate governance statement on their website be considered further? If so, are there any elements of the corporate governance statement that should always be included in the annual report?

No we do not support corporate governance statements being put on a corporate website. We consider this proposal has the potential to erode the value of corporate governance by relegating it in status. The Annual Report is the correct home to disclosure such pertinent information on the governance strategy and structure.

More focus should be placed on ensuring the quality of corporate governance statements are improved rather than removing them from the Annual Report. Investors believe that corporate governance reporting by companies must focus more on the application of the Code Principles rather than just compliance with provisions. In this sense, we support the notion of 'Apply and Explain'.

The new Preface to the Code urges Chairmen to report personally in their annual statements how the principles relating to the role and effectiveness of the board (in Sections A and B of the Code) have been applied. The ABI's review of Code explanations in 2012 found that companies with a Chairman's introductory statement to the corporate governance section scored on average considerably higher in terms of quality of explanation. We recommend that all companies adopt a Chairman's introductory statement to the Corporate Governance section of the annual report and for the FRC to consider incorporating this into the Code as a provision.

Question 12: Are there any disclosure requirements in the Code that could be dropped entirely?

No. However, we would direct you to our preamble where we highlight the importance of culture and ethics and would encourage the FRC to incorporate our suggestions into the revised Code. In addition we highlighted the UNEP FI's report which proposes a model of Integrated Governance² that puts sustainability at the heart of governance and corporate boards' strategic agendas. The Integrated Governance model is the system by which companies are directed and controlled, in which sustainability issues are integrated in a way that ensures value creation for the company and beneficial results for all stakeholders in the long term. The report illustrates the inadequacies of

² <http://bit.ly/1kXm4HI>.

current corporate governance practices and outlines three phases that help companies move towards Integrated Governance, leading to a holistic integration of sustainability in their corporate strategies.

At the time of its release we publically endorsed the report commenting; We look to invest in companies that integrate corporate sustainability issues into long term business strategy as we think this pays dividends to shareholders as well as society. Unfortunately, Governments have largely overlooked this important area, and are lagging a long way behind the corporate best practices outlined in this report. Aviva Investors now call on all global governments to ensure that their national corporate governance codes promote integrated governance. The draft UN Sustainable Development Goals provides them with the perfect opportunity to deliver.

How this might be incorporated into the Code:

The contemporary business environment demonstrates that it is important for both shareholders and stakeholders that the Code does more to help shape the cultural and ethical framework for UK businesses. This broad area is covered in section A of the September 2012 iteration of the Code, entitled Leadership. However, we do not believe this represents a sufficiently integrated and thorough approach. Guidance on ensuring that a company's values and standards are understood and met should also appear in the sections on Effectiveness, Accountability, Remuneration, and Relations with Shareholders. We also believe that the Code should be explicit on the responsibilities of the Non Executive Directors, the Risk Management and Internal Control function, the Audit Committee and Auditors and the design of performance related remuneration for executive directors.

Similarly, from an internal control perspective, the annual report narrative should describe the role of the Board in overseeing risks arising from the values and standards of the firm management. It should address whether the Board has ensured that the company has in place effective systems for managing and mitigating significant risks arising from breaches of the values and standards of the firm, which, where relevant, incorporate performance management systems and appropriate remuneration incentives.

Whilst culture is mentioned as a supporting principle in A.3 of the September 2012 iteration we believe there is scope for greater emphasis on this area and is a gap that this consultation can and should fill. Practical examples may include:

- Articulating more forcefully the role of the Chairman and the Board in promoting the right culture and the need to act with integrity and respect for all shareholders and stakeholders. We have seen how inappropriate behaviour has contributed to the financial crisis and the furore over bank pay.
- Explicitly state that Boards should ensure they are reassured that audit and risk committees are not focused just on the most expedient considerations for the short term e.g. doubtful accounting approaches but focused on the long term interests of the company.
- Propose proper, externally managed whistle-blowing processes available to staff as good practice.

- Propose that companies should adopt an integrated reporting approach where practical. This is a rubric we commend to our investee companies both formally and through our engagement process.
- The approach to culture and ethics and the processes around facilitating this culture should be disclosed and transparent

We would be more than happy to elaborate on our views in this arena.