

Stephen Hadrill
Chief Executive Officer
Financial Reporting Council
By email

28 February 2018

Dear Mr Hadrill,

Financial Reporting Council's Proposed Revisions to the UK Corporate Governance Code

The International Integrated Reporting Council welcomes this consultation on the proposed revisions to the UK Corporate Governance Code and the opportunity to comment. The UK Corporate Governance Code has long been considered a leading example internationally of how corporate governance should be shaped and we believe these proposed revisions will only strengthen the regard with which this code is held. Company purpose, value creation and the acceptance of wider economic, social and environmental matters are becoming part of the mainstream dialogue between company management and institutional investors, as well as contributing to trust between business and society. It is in this context that we welcome these proposed changes to the Code.

UK Corporate Governance Code and Guidance on Board Effectiveness Questions

Q1) Do you have any concerns in relation to the proposed Code application date?

We have no concerns.

Q2) Do you have any comments on the revised Guidance?

Given the important work that the FRC has done to ensure directors are focused on the long term sustained success of the company, we believe that the guidance places too much emphasis on shareholder primacy in paragraph 10.

We would welcome the addition of language around the board's responsibility for corporate reporting, giving clear guidance that an annual report should reflect the collective mind of the board. The guidance should encourage the board to take full responsibility for the reporting issued by a company, including information that goes beyond financial information to ensure they are placing due regard on this information.

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

We are pleased to see that both the government and the Financial Reporting Council are bringing attention to the importance of boards taking into consideration the needs and views of key stakeholders including employees. Both 'human' and 'social and relationship' capitals are fundamental to the way organizations create value.

For these issues to be taken seriously they should be the concerns of all of the board – not just one individual. It is crucial for the board to think and work holistically rather than in siloes and, therefore, whilst we support the recommendations set out in Provision 3, we would encourage additional wording that makes it clear that the entire board must understand and pay due regard to the views of the workforce as well as other key stakeholders in formulating and executing strategy.

The three options set out in Provision 3 are sensible and rightly provide space for organizations to identify the approach that works best for them to facilitate interaction with the workforce. However, the Financial Reporting Council should ensure that organizations do not take advantage of this flexibility to evade their responsibilities.

We encourage further recognition of the importance of other key stakeholders in formulating company strategy and suggest the code includes recommendations around undertaking a key stakeholder determination process and holding regular stakeholder forums.

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?

Every business should understand and actively play their role in achieving the SDGs. It is clear that for Agenda 2030 to be a success it will take the efforts of governments, businesses, investors, charities and the public sector together. The FRC should therefore be encouraging this by providing support and signposting businesses towards practical tools and resources such as the IIRC's 'The Sustainable Development Goals, integrated thinking and the integrated report' so that businesses have the ability to actively contribute to the SDGs.

However, ultimately for a business to make a real contribution to the SDGs, it must be a strategic decision rather than a box ticking exercise. Furthermore, given the breadth of the SDGs, it will be necessary for businesses to identify those SDGs to which it can make the most meaningful contribution. We would therefore suggest that any reference to the SDGs is focused on encouragement rather than prescription – encouraging them to identify the goals relevant to them and setting out how they can ensure that the achievement of the goals are compatible with the daily strategy of the business.

Given the growing risk of climate change, we suggest the FRC includes a reference to the Financial Stability Board's TCFD recommendations encouraging businesses to implement them, if not explicitly in the Code, then certainly in the Guidance. The TCFD recommendations are consistent with achieving a greater focus on cohesiveness and integration of material factors, principles supported by the FRC.

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?

We believe that the 20 per cent threshold is a sensible recommendation and welcome the inclusion that an update should be published no later than six months after the vote. We believe that this update should also reflect on the view and any impact on broader stakeholders where appropriate.

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.

We believe that diversity is essential to achieve optimal value creation, effective decision-making and corporate governance. We therefore support an extension of the Hampton-Alexander recommendations beyond the FTSE 350.

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?

The FRC should ensure that all requirements are clear and understandable to avoid any confusion in their implementation. If it is necessary for there to be duplication then there should be no discrepancies and it should cause no additional burden to an organization.

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?

In line with the Corporate Governance Code, we believe it is crucial that remuneration is aligned with strategy. However, we believe further clarity is needed in the section on remuneration setting out that strategy and performance is about the holistic value creation of the company across human, natural, social and relationship factors, rather than a narrow focus on financial factors alone.

Expanding the remit of the remuneration committee to enable them to engage with the workforce on this topic is also important given the growing sensitivities around executive pay in the UK. Directors must be clear to the workforce, other stakeholders and shareholders how remuneration is set and how it is effected when performance is not in line with strategy – both financial and non-financial. A company should also have policies in place for how to respond to discontent or unease amongst key stakeholders over these issues.

We welcome the emphasis provided in the code that we believe will bring about further transparency in the annual report on these issues.

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

See above.

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

The suggestions set out in the FRC’s consultation document surrounding how investors confirm their commitment to long termism and confirming that they are paying due regard to extra financial information, including information provided by companies using the TCFD recommendation, are in line with the IIRC’s efforts to encourage effective investor stewardship internationally.

Q21. How could an investor’s role in building a company’s long-term success be further encouraged through the Stewardship Code?

Extra financial information often only has an impact in the future. By strengthening the stewardship code to encourage investors use this information in their capital allocation decisions it will create the conditions for building long term success in companies.

Q22. 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 any specific areas of focus that should be addressed?

Wider stakeholders have an increasing impact on company value creation. Taking into consideration their views for monitoring and engagement purposes could provide an important indicator of effective governance, as well as signal material risks and opportunities that should form the basis of dialogue between the board and investors. This will also encourage investors to use the information provided by companies in their investment decision-making processes. Investors should be asked to confirm whether and how they used extra financial information across natural, human, social and relationship factors in their decision-making.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

Principle 6 of the International Corporate Governance Network Stewardship Code: “Investors should promote the long-term performance and sustainable success of companies and should integrate material environmental, social and governance (ESG) factors in stewardship activities” is an important means of encouraging investors to take a balanced view of value creation – in line with the FRC’s proposed revisions to the Strategic Report and will help install long termism in investor decision making.

Principle 7 of the Japanese Stewardship Code: “To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities” should also be considered as an example of how investors are encouraged to look beyond purely financial information before making capital allocation decisions.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

We wholeheartedly support the FSB TCFD recommendation that climate related risk should be identified and managed as part of existing risk management processes within the company. We would therefore welcome the Code giving explicit due regard to how investors use information on climate change, however, the code should avoid being too prescriptive. There are some companies for which natural capital information will not be relevant to their business model and therefore is not material to investor decision-making.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

Yes, it is important that investors are clear on what they perceive their role to be as stewards of the organizations they invest in and their purpose in playing this role. Defining this purpose provides clarity as to the expectations and ambitions of the investor and how it takes into consideration the needs of its own stakeholders in exercising its duties.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

This approach should be encouraged as best practice, including how the asset manager has taken into consideration factors across the value creation process such as natural, human, and social and relationship factors.

Your sincerely,

Jonathan Labrey
Chief Strategy Officer