

Catherine Horton
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

codereview@frc.org.uk

7 March 2018

Dear Catherine,

BMO Global Asset Management's Response to Proposed Revisions to the UK Corporate Governance Code

We welcome the opportunity to respond to the proposed revisions to the UK Corporate Governance Code (the Code) and the Guidance on Board Effectiveness, as well as the high-level questions on the UK Stewardship Code.

BMO Global Asset Management (BMO GAM), whose institutional and retail clients collectively represent over £185 billion¹ of assets. In addition, we have been authorised to vote and/or engage in dialogue on behalf of a further 32 investment institutions with assets totalling over £120 billion².

In 2017, have conducted approximately over 1000 engagements on Environmental, Social and Governance issues with 676 companies in our global portfolio.

We welcome the FRC's efforts to update the Code to reflect evolving investor expectations of companies and to maintain high standards of corporate governance in the UK.

We believe that the Code will be most effective if it remains structured around high-level principles without being too prescriptive. All changes to the Code should reinforce the "comply or explain" approach, so that companies feel free to provide well-reasoned, thoughtful explanations which are linked to their business strategy and outline how risks of diverging from the Code have been minimised.

We welcome many of the FRC's proposed revisions to the UK Governance code, such as the emphasis on corporate culture, diversity and audit committee competence. We are also supportive of focusing executive pay on longer-term outcomes by introducing post-vesting holding periods and a better alignment of performance metrics to corporate strategy; BMO GAM has promoted this approach for a number of years.

We have chosen to provide specific responses to the questions and themes where we believe our feedback would be most meaningful. We draw on our experience as an institutional investor which engages with a large number of companies globally and we hope you will find our views useful.

¹ As at 30 September 2017

² As at 31 December 2017

Board service and independence

We believe that prolonged membership on a Board jeopardises independence as directors may become close with management and overly invested in prior strategic decisions. We, therefore, welcome the change to the Code whereby non-executives will automatically be deemed not independent due to prolonged tenure. Under the current system companies can continue to provide spurious or no reasons to justify their classification of the director as independent.

We would like to stress, however, that, while we value independence of individual directors, above all we value a well-balanced Board. In the context of a balanced Board, we will support non-independent directors when they bring skills, sector or geographic knowledge and other experience that justifies their presence on the Board, particularly where the appropriate balance of independence is maintained. Therefore, we do not support a maximum period of tenure for any directors on the Board, either executive or non-executive.

We will expect companies to engage with investors on succession plans for long-serving directors and overall Board refreshment strategy. We would also caution against potential unintended consequences of Board evaluations becoming overly focused on tenure-linked independence. We are therefore supportive of strengthening independent Board evaluation principles under the new Code. As investors, we expect companies to develop Board evaluation strategies that align with the needs of their businesses and are forward-looking, as well as retrospective.

Independent Board leadership

We have concerns over the new Code's proposed provision whereby the Board Chair would be expected to be independent throughout their tenure. We do not believe that it is appropriate to apply independence criteria to the Chair on an on-going basis, as their role is significantly different to that of other non-executives.

We see effective Board leadership as a key component of good corporate governance and long-term value creation, yet the role of the Chair is more complex and demanding than ever before. Chairs spend considerably more time in the business alongside executives, making it more difficult for them to retain their ongoing independence. In this context, the ability to commit the necessary time to Board business is an essential trait for Board leaders to be effective.

We believe that extending the nine-year independence provision to the Chair will discourage Boards from promoting non-executives to Chairs, as their tenure as Chair may be limited by the years already spent on the Board. The unintended consequence of this change may be that all Chairs are appointed externally rather than internally. This could have an impact on overall Board effectiveness.

We believe that the Code should be explicit on the composition of the Board if the Chair is not considered independent. Specifically, we expect the Code to retain the existing approach that the Chair should, on appointment, meet the independence criteria, but that "thereafter the test of independence is not appropriate in relation to the chairman". Consequently, calculations of Board independence should exclude the Chairman, as is currently the case under B.1.2. which states that at least half the board, excluding the chairman" should be independent. In addition, given the significant difference in size between companies in and below the FTSE 350, we support retaining the exemption for smaller companies, whereby smaller company should have at least two independent non-executive directors with a requirement to explain why a majority independence has not been reached.

Revised Guidance and the role of the senior independent director

We strongly believe that the Board should proactively make itself available for consultation with shareholders on any substantive matter, whether or not it forms the subject of a vote, and should, to this end, appoint a senior independent director to fulfil a formal liaison role, in addition to the Chairman and where the Chairman may be conflicted. Therefore, we recommend that new Provision 5 should incorporate the essence of exiting Provision E.1.1 which states that “[t]he senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.”

Diversity below Board level

We believe that more needs to be done to encourage greater gender diversity on Boards and below Board level. We are supportive of market-based initiatives such as the Davies and Hampton-Alexander Reviews and over the past two years, we have engaged extensively with companies on this increasing levels of diversity.

We support the FRC’s proposal to require FTSE 350 companies to disclose the gender balance on the executive committee and direct reports to the executive committee within their annual report. Furthermore, we would propose that FTSE 350 companies report to investors on their plans and initiatives for and potential hurdles to growing the number of women at executive committee level.

Many approaches, such as mentoring schemes and greater assessment of the pipeline, that have been used to improve gender diversity at board-level and in the executive pipeline, could be applied to improving other kinds of diversity, such as ethnic diversity. We would support guidance for companies finding ways to measure and report on ethnic diversity as a first step before inclusion Code.

Stakeholder engagement

We welcome the increased focus in the revised Code on the importance of Boards understanding and taking into account the views of their stakeholders in their long-term decision-making. As investors, we expect companies to take decisions which will generate the best long-term value for their shareholders. We see failure by companies to take account of the views of stakeholders, including their workforce, as a potential impediment to their future success. We, therefore, encourage companies to identify their material stakeholders, depending on their business model, and engage in constructive dialogue with them. Boards can then consider the views of these stakeholders as part of their long-term decision-making.

We recognise the importance of effective labour management and are well aware of the severe issues that can face a company when workforce matters are not managed appropriately. However, we are not supportive of ideas for workforce representatives on UK company boards and are concerned that this could potentially disrupt the one-tier board model and be problematic under the exercise of Directors’ Duties as set out in section 172 of the Companies Act.

We support the increased focus in the revised Code on the importance of boards understanding and taking into account the views of their stakeholders (of which the workforce is most commonly the key one) in their long-term decision-making. We believe that robust engagement and reporting mechanisms can complement and support existing legal provisions when Boards actually reflect stakeholder discussions in their decision-making.

Reference to the UN SDG's within the Code or Guidance

As an investor, we encourage Boards to consider the potential impacts of relevant environmental, social and governance (ESG) factors on a company's long-term business strategy. We see the Sustainable Development Goals (SDGs) as an important framework with which a range of company stakeholders, including shareholders, can assess the company's impact on society. However, we do not believe that the Code, as a framework for governance of companies, is the most appropriate place to include a reference to the SDGs.

However, we would welcome the inclusion of a reference to the SDGs within a guidance to Code with an aim of encouraging company reporting on against the framework.

Remuneration committee responsibilities and long-term performance

We support the addition of the Provision, which expects remuneration committee Chairs to have served on the remuneration committee for at least 12 months. We urge the FRC to clarify that this experience should be of service on the remuneration committee itself (not another company's remuneration committee), prior to the director becoming Chair of the committee. This would allow the Chair time to develop understanding of the company's strategy, what drives performance, the culture of the company, the shareholder base and the wider workforce population.

For a number of years now, we have urged companies to set up long-term incentive plans with vesting periods that extend to five years or longer. We have also encouraged companies to require longer-term holding periods post vesting, particularly where vesting periods are less than five years.

We, therefore, welcome Provision 36 and consider the proposed five-year holding periods to already be market norm. We also find the ability of Board to override formulaic pay outcomes to be an important area for director discretion (Provision 37). As an investor, we hold directors ultimately accountable for remuneration decisions and their outcomes.

Proposed Code application date

Given increased public scrutiny over corporate governance in the UK and questions about whether the Code is able to restore public trust in business, we believe that the proposed Code should come into effect as soon as possible. Whilst we recognise that implementing a new Code for year ends any earlier than January 2019 may not present a sufficient timeframe for all companies to respond to the proposed changes to the Code, we would encourage an FRC recommendation for early application of the Code on a best efforts basis. We believe this could help allay concerns over whether the system is fit for purpose and can help silence calls for a strict, regulatory approach to corporate governance.

Questions on the Stewardship Code

We take our obligations under the Stewardship Code seriously and report extensively on our stewardship activities to our clients and publicly.

We do not agree with a compliance approach to stewardship though codifying certain issues that investors must engage on, such as ESG and social impact. As stewards of our investee companies, we must decide

what issues are most material to the long-term success of our investments and engage on these points, rather than referring to an arbitrary list of topics. The Stewardship Code is a high-level code, which should not set out what issues investors should be engaging on.

We would, however, welcome questions in the Stewardship Code to disclosure how signatories exercise their stewardship responsibilities asset classes, other than equity

We also urge that the FRC devotes attention to highlighting what best practice stewardship looks like, and how asset owners are able to judge the quality of stewardship between different investment managers.

We are aware that there is a range of stewardship practices across the market but feel that the Stewardship Code can more clearly set out the role of asset owners and other parts of the investment chain with regard to stewardship.

We would not supportive of the Code asking asset managers of their approach on directed voting in pooled funds. Clients who choose to use a pooled fund are aware that shares held in pooled funds will be voted in accordance with the investment manager's voting policy and segregated mandates are available where directed voting is a requirement.

We hope you find our feedback useful. Please contact Kalina Lazarova, Vice President, GSI, if you would like to discuss any of our responses in further detail.

Sincerely,

Kalina Lazarova

Kalina Lazarova
Vice President, Governance and Sustainable Investment
BMO Global Asset Management (EMEA) *(Formerly F&C Investments)*

Direct: +44 (0)207 011 4282
Mobile: +44 (0)7738 023 157
Email: kalina.lazarova@bmogam.com
www.bmogam.com
A part of BMO Financial Group

