

## **Response to the FRC consultation on the UK Corporate Governance Code and the Stewardship Code**

### **Q1. Do you have any concerns in relation to the proposed Code application date?**

Yes. If you keep the proposed changes relating to independence some companies will find they no longer comply with the requirement to have a majority of independent directors but will not have enough time to appoint more directors to meet this requirement. They may want to comply rather than explain, but not have enough time to do so. Also for companies below the FTSE 350 where there are significant changes there will not be enough time to adjust.

### **Q2. Do you have any comments on the revised Guidance?**

No.

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

Although this may help to encourage better practice, it cannot ensure there will be meaningful engagement. The second sentence of Provision 3 should make it clear that a company may adopt one or more of the methods set out – or another method which it describes in its annual report. The word “normally” does not appear to give a company a choice to do something different, it rather suggests that a company will usually choose one of these methods. If you intend to allow companies to choose another method, this needs to be clearer. The term workforce is imprecise. It may have different meanings in different countries. This could make it hard for a company to know whether it is complying or not.

### **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.

### **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?**

Yes.

### **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.**

Yes – but will companies have until 2021 to meet this provision?

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

Yes. However, I do not agree with the proposed changes relating to the board’s discretion to determine whether a director is independent or not. If there are concerns that companies have determined that a director is independent but have refused to state their reasons for this, the answer is for the FCA to take action under the Listing Rules for failing to meet the Listing Rule requirement. Provision 15 is not sufficiently clear for a company to decide if it is complying or not. For example, what is a close family tie – does it include step-parents or step-siblings or adult brothers or sisters? What is a significant link with another director and what is a significant shareholder? As presently

written, this does not cause a problem because the company can use discretion. It would be better to retain the current approach and reinforce the requirement for disclosure.

There is no explanation of the change of approach to the independence of the chair. Is the intention that chairs should also be subject to the 9 year rule? The proposal may have the result of making it less attractive to appoint an existing director as chair – which does not seem sensible.

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

Yes.

**Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company**

**as a whole?**

Not necessarily. Section 3 is focussed mostly on the board and only deals to a very small extent with succession planning. It is disappointing that the FRC has not required boards to set out in their annual report how they believe the composition of the board and the skills and attributes of the directors will contribute to helping the company meet its strategy and objectives.

**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.

**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.**

If there is to be reporting, there needs to be a clear agreement as to what the reporting is against, rather than leaving it to each company to decide its own approach.

**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?**

Will Provision 4 be amended to reflect the proposed secondary legislation exactly? It would be unhelpful for it to be different. Generally I would prefer to remove duplication. If provisions are retained, they should use the same wording as the other requirement. For overseas companies, you could make it clear that they are expected to comply with the relevant provisions (if they do not otherwise apply) as if they were a UK company.

**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

**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?**

It is not clear what a remuneration committee would need to do to “oversee” remuneration and workforce policies and practices. This could be particularly difficult for companies with operations in many overseas countries, where the policies and practices will reflect local requirements. If the aim is to try to ensure that director remuneration is proportionate when compared to the amounts paid to

the workforce, would it be more sensible to limit the comparison to the part of the workforce in the country where the company is registered?

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

No comment.

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

The changes are not unhelpful, but change is more likely to come from pressure from society at large.

#### **UK Stewardship Code Questions**

**Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?**

Yes. It would be better for the Stewardship Code to be more like the Corporate Governance Code, setting out best practice in more detail. Separate codes or enhanced guidance for different parts of the investment chain are needed to reflect their different roles.

**Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?**

Yes. Presumably discussions with those who would be subject to the Code or Codes (or guidance) and with companies would be helpful in determining best practice.

**Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?**

It would be helpful to encourage companies to advertise their tiering to the public and to clients – so that there comes to be more public understanding of this and more pressure to follow the highest standards. Alternatively you could use another sort of rating system e.g. gold stars.

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

It would be helpful if there was an emphasis on the need to engage with companies and on the need to consider explanations where companies explain rather than comply. In particular, it would be helpful to set an expectation that investors and proxy advisers will explain why they have voted against a resolution or abstained.

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

No comment.

**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 is an imprecise term – and companies may differ as to who they identify as their stakeholders. Investors could be encouraged to consider the groups that the company has identified as its stakeholders and to consider whether the way in which the company is engaging with them is likely to contribute to the long-term success of the company. A similar approach could be taken for ESG factors. Not all ESG factors will be equally relevant for all companies – so there needs to be flexibility for the investor to consider whether these are relevant to an investee company and, if so, whether the action the company is taking is appropriate or not for long-term success.

**Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?**

Fund managers will already have requirements to report to asset owners, but it would be helpful to encourage more of them also to make a public statement about their general approach to stewardship activities. Asset owners (e.g. pension funds) are not always good at reporting to their beneficiaries about the requirements they set for asset managers or the extent to which they monitor their managers' activities. More could be done on this.

**Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?**

No comment

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

It would be a good idea to include something on stock lending.

**Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?**

No comment.

**Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?**

Yes.

**Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?**

Yes.

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

Yes.

**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.

**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?**

It would be helpful for an individual fund to have to disclose its purpose and specific approach to stewardship. It would be helpful to know if the approach to corporate governance is dealt with by corporate governance professionals or by fund managers with an understanding of corporate governance or some combination. It would also be helpful to understand the relationship on decisions where a proxy adviser is used – and who has the final say on a vote against or abstention on a resolution.

#### **Other comments**

**Introduction:** It is important that the Code is understood to be a statement of best practice. In various places, the wording used is similar to that of the Companies Act, but differs from that. It would be very helpful to include an explicit statement in the introduction to make it clear that the Code sets out best practice and is not intended to alter or substitute for any legal requirements.

The Listing Rules require companies to state how they have applied the Principles – so it is important that the Principles do not take away the flexibility the company may need to achieve a successful strategy.

**Principle A:** It is not necessarily the board's function to promote the long-term sustainable success of the company or to contribute to wider society. This is set by their constitution. I suggest Principle A is reworded to say "A successful company is led by an effective and entrepreneurial board. The board should consider what is needed for the long-term sustainable success of the company to generate value for shareholders and should consider the company's role in wider society. The board should establish the company's purpose, strategy and values, and satisfy itself that these and its culture are aligned."

**Principle C:** A company does not necessarily have legal responsibilities to all stakeholders (and it is not clear who comes in the definition of stakeholders). It is therefore unhelpful to require companies to apply a principle that assumes the company does have responsibilities to stakeholders. I suggest this say instead "In order for the company to meet its responsibilities to shareholders and have regard to the need to foster relationships with stakeholders....."

**Principle D:** It is not obvious what a director would need to do to "lead by example in the best interests of the company". Where a director is a director of more than one company, if the companies have different objectives there could be problems in demonstrating they had done this for both companies. I suggest this is reworded to say " In acting as a director of the company, a director should act with integrity having regard to maintaining high standards of business conduct." This would also fit better with section 172 Companies Act 2006.

**Provision 2:** What is meant by "embody"? Again where a director has more than one directorship I think this could cause problems. I suggest this is deleted and there should just be a requirement to promote the desired culture of the company.

**Provision 5:** should refer to major shareholders throughout.

**Provision 7:** the Companies Act does not require directors to eliminate conflicts of interest, Instead directors must declare them and the company must address them in some way (this can be by shareholder or independent director approval or by managing them e.g. a director not taking part in particular discussions). I suggest you change “eliminate” to “address”. The board cannot “ensure” that the influence of third parties does not compromise or override independent judgement. I suggest you change this to “with the aim that the influence of third parties .....”.

**Principle G:** I suggest you add “if they have any “after “offer specialist advice”.

**Provision 13:** I suggest you revert to the existing wording to reflect the law, where the whole board is responsible (although independent directors may take the lead on making proposals).

**Provision 14:** It seems too onerous to require all external appointments to be approved by the board before being made. It may be enough for the company to have a policy as to what sort of appointments need to come to the board and for the general counsel or company secretary to make a decision about appointments (e.g. to a small charity or trustee of a family trust) that do not need to come to the board.

**Principle I:** The board cannot ensure the independence and effectiveness of external audit. I suggest you replace “ensure” with “promote”.

**Provision 33:** This should refer to the remuneration committee setting executive director remuneration. The non-executive director remuneration is normally set in the company’s articles.

**Provision 38:** The pension arrangements of the workforce will depend on where the workforce is based and local laws on pensions. It does not make sense to align the pensions of directors in one country with the pension arrangements for the workforce from another country or countries.

#### **Items removed from the Code**

I suggest A.1.3, SP B.1, E.2.1 and E.2.4 (so far as it relates to 20 business days) be moved to the Guidance.

28 February 2018