

## Email

20 February 2018

Dear Sir

We are delighted to have the opportunity to respond to the FRC's consultation on Proposed Revisions to the UK Corporate Governance Code.

We are a UK based investment manager who invests globally on behalf of clients (predominately domiciled in the UK). We are investors in UK listed entities. As specialist ethical and responsible investors we take an informed approach to proxy voting, registering our votes in all markets consistent with local best practice. Corporate Governance is of strategic importance for us, and is taken into account when making investment decisions. A strong, supported corporate governance regime, in our view, provides the necessary reassurance required to attract inward investment and allocation of capital.

UK proxies are voted in-house in accordance with our detailed UK Corporate Governance Policy published at [www.edentreeim.com](http://www.edentreeim.com).

We concur with the overriding tone of the consultation regarding culture, but note some caution in pre-determining a need to shorten the Code from its current structure which has served stakeholders and companies well. Lessening detail and nuance could have unintended consequences in reducing commitment.

Whilst compliance is good (noted page 3), a glaring omission is its application to London listed but non-domiciled entities (IOM and Channel Islands) and to the Alternative Investment Market (AIM). The latter in particular should be required to achieve some minimum standards of governance given capital is being allocated to public companies in a regulated market. This may not be a matter for the FRC, but we urge the Council to exert its influence to engage those markets in some compliance. A minimum standard for these 'outriders' enforced by Listing Rule 9.8.6 (5 & 6) would be inordinately positive.

Our detailed comments follow the FRC's consultation paper by question number.

**Q1** No comment – the timeline is appropriate.

**Q2** No comment – subject to additional guidance emerging from the consultation, we are content with the proposal.

**Q3** We warmly support Provision 3 and support its aim of improving company-workforce relations via a designated methodology. We are open to companies retaining flexibility on the method (or none) adopted. We are open to the appointment of a dedicated worker

NED, but note this would not count towards Board independence which might otherwise be reduced. Given the need to avoid being prescriptive we believe the tone of Provision 3 should be sufficient to 'achieve meaningful engagement' so long as any exception to the Provision is explained.

**Q4** We strongly support the need for companies to consider and state their wider role and responsibilities to society and the social purpose they deliver in terms of job creation, the provision of goods and services, ethical behaviours and wider corporate citizenship. On a comply or explain basis, we believe companies might be 'encouraged' to disclose how their business aligns with the SDGs as these are universal and international, however we are not persuaded that the Corporate Governance Code (rather than the Strategic Report) is the correct forum to include them. Companies are subject to a wide range of 'voluntary pressures' e.g. UN Guidance on Business and Human Rights that impact them, and so on balance we view a general reference as set out in Provision 4 to be an appropriate way forward that invites companies to set out their social purpose and how they engage with stakeholders in broad terms.

**Q5** We do not view this proposal as helpful and may have unintended consequences. Voting decisions are largely decided by a handful of global proxy agents that register 'contracted-out' ballots on behalf of institutions. Secondly 'consultation' may only result in companies talking to their largest shareholders (as usual) with little relevant outcome for smaller shareholders. The IA now maintains a public register of dissenting votes and this provides scrutiny and accountability. In general, companies should be encouraged to consult with a wider body of shareholders following any material dissent, but we would not, on balance, wish to mandate the level of opposition – owing to quirks in proxy providers voting policies some routine resolutions attract considerable opposition e.g. authority to hold general meetings at 14 days' notice

Note: Para 41 – we have strong objections to the removal of the reference to 'improprieties in matters of financial reporting' as this is critical to enforce obligations and to provide market assurance. We would prefer this phrase to remain as 'improprieties in matters of financial reporting or other matters'

**Q6** Whilst recognising the principles of good governance are universal the specific circumstances of smaller companies should allow the governance regime to remain appropriate and flexible on a 'comply or explain' basis. Whilst para 49 states companies outside the FTSE350 may be of a similar size and structure, clearly many are not. For the smallest companies such provisions may represent a disproportionate burden and this should be borne in mind. However we are content with a general requirement to remove exemptions in support of a comply or explain approach including Board

evaluation every three years, which we view as standard best practice. We strongly support the move to make the Chair a designated NED at all times – the recent ‘aberration’ (independent on appointment but neither executive nor non-executive) has led to the unintended consequence of extreme compensation ratcheting for FTSE100 chairs as well as creating unnecessary confusion as to their status

**Q7** Yes. We view the nine year term limit as the definition of independent to be appropriate and reasonable. We support this being extended to include the total term of an NED including one that goes on to become Board Chair

**Q8** On balance we are content for there to be no set maximum term; however in a very few instances where NEDs have served much longer terms (say 12 years and over) we would support a requirement to make a stronger statement of justification for continuing to support re-election – this should be in the context of overall Board structure, independence levels, diversity and the need for refreshment

**Q9** Yes; we strongly support the proposed changes in Provision 17 and 23 requiring companies to report on how they are overseeing the development of a diverse pipeline. We are supporting investors of the aspirations set out by the 30% Club, and have integrated diversity fully into our UK voting policy

**Q10** We strongly support the proposed changes to be extended to all companies as the benefits of diverse Boards is universal. We do not believe asking companies to report on this would lead to a disproportionate cost; we recognise for smaller companies with fewer Board members, achieving a more diverse mix may be challenging, however the wider benefits suggest the Code should encourage smaller companies to disclose their approach to developing diversity

**Q11** We view gender diversity and broader cultural and ethnic diversity to be essentially different as women make up 50% of the population. However, the cultural richness of diverse experiences as set out in the Parker review is welcome. We would support the Code ‘encouraging’ companies to comment on cultural and ethnic diversity without being prescriptive; at this stage we have no comment either way on whether companies should report on levels of ethnicity in executive pipelines as without context this could be detrimental and subject to misunderstanding

**Q12** Yes. We strongly support retaining the current requirements contained in the Code around audit and risk.

Provision 24 We strongly recommend the FRC provide more clarity on what constitutes 'recent and relevant financial experience'. Relevant competence is critical to informed audit oversight, and we would welcome the FRC stating what this means

**Q13** We have no comment on this proposal, although the revision, in our view, serves little benefit and we would prefer to see it left unchanged

Paras 75-77 We support these proposals, however they are so critical to the assurance of a functioning market they should be part of Company Law and the Listing Rules rather than the Code

Provision 26 The company should be required to defend the re-appointment of an incumbent external auditor following a tender if the incumbent has been in place for some-time. We strongly support company disclosure on the presence (or absence) of an internal audit function. The company should be required to disclose if this function is outsourced

**Q14** We support the Remuneration Committee having a working brief to oversee pay more widely; in practice we believe this will be driven by HR departments, grading scales and market norms. However, bringing it within the role and responsibility of the Remuneration Committee may help to mitigate the disconnect between executive pay growth and the wider workforce. The Remuneration Committee should be expected to disclose how it has effected this oversight. The setting of NED fees is opaque and has been subject to escalated ratcheting; we would welcome more disclosure on the justification for the fees paid, and in particular to those of the chair

**Q15** We have long taken the view that executive pay is sclerotic and dysfunctional and tends towards rewarding generously for 'in-line' performance.

We would support market moves to reduce contract terms over time from one year to six months; long severance terms fuel rewards for failure.

We would be supportive of companies employing flexibility and novel thinking in how executives should be rewarded. The current model is the result of group-think, recommended by advisors so that all schemes appear similarly dysfunctional.

We would support moves to break with thinking and emerge with new models of reward which may be more fixed pay based or alternative models of variable reward.

Companies should be encouraged to avoid grants that vest at threshold or median performance where under or in-line performance is unjustifiably rewarded.

The basis and rationale for all performance measures chosen should be properly and fully disclosed

Single metrics should be avoided and we would like to see the wider use of 'cultural' performance targets such as building diversity, health & safety, reducing emissions etc. to be seen as relevant as more familiar financial metrics such as EPS, TSR or ROCE

We are cognisant that in certain circumstances, the Remuneration Committee may need to apply discretion in applying the Remuneration Policy; in general we expect the Committee to apply any discretion, especially when this may be to the advantage of executives, sparingly and with caution

We strongly support the Board's ability to interrogate and reject Remuneration Policies proposed by the Remuneration Committee, and we would welcome more disclosure on the interplay between the two, including instances where their views have diverged

**Q16** We should like to think the outcomes would be positive, however current FRC proposals in our view will not achieve this

Provision 32 – This requires more clarity as it is unclear whether the 12 months experience is in total or at the same company; we would prefer it to be specific to the current position rather than previous experience; however, we strongly support the Chair of the Remuneration Committee having 12 months in-situ experience; the competency and skills of the Committee are relevant to provide assurance that its role can be exercised independently of advisors and consultants

## **UK Stewardship Code**

Q17-31 We intend this submission to be solely in response to the consultation on the UK Corporate Governance Code. We would hope to provide a response to the detailed consultation on the UK Stewardship Code when this is announced later in the year and prefer to withhold specific views on the Code for the time being.

We thank you for the opportunity to consult on the FRC's proposals and thank you for taking our views into consideration.

Kind regards, Neville White

Head of Corporate Governance

EdenTree Investment Management Ltd