Financial Reporting Council

December 2018

Feedback Statement

The Wates Corporate Governance Principles for Large Private Companies

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

1 INTRODUCTION

1.1 In its response to the Green Paper on Corporate Governance Reform, the Government stated that the case had been made for strengthening the corporate governance framework for the UK's largest private companies, noting 'the conduct and governance of large companies, whatever their legal status, has a sizeable impact on the interests of employees, suppliers, customers and others'.[1] In addition, the Government stressed that it was in the interests of businesses themselves to have strong corporate governance, stating: 'It provides confidence not just to shareholders, but to other key stakeholders, including the workforce, customers, suppliers, pensioners and the environment, that a company is being well run.'

1.2 In August 2017, the Secretary of State for Business, Energy and Industrial Strategy, the Rt Hon Greg Clark MP, asked the Financial Reporting Council (FRC) to set up a coalition and act as secretariat to take forward this work, and appointed James Wates CBE as Chairman of the Coalition Group in January 2018. The aim of the group was to develop a set of corporate governance principles for large private companies.

1.1 The membership of the Coalition Group comprises the British Private Equity and Venture Capital Association, the Climate Disclosure Standards Board, the Confederation of British Industry, ICSA: the Governance Institute, the Institute of Business Ethics, the Institute of Directors, the Institute for Family Business, the Investment Association, independent member Mark Goyder, and the Trades Union Congress.

1.2 The draft Wates Corporate Governance Principles for Large Private Companies (Wates Principles) were issued on 13 June 2018 for public consultation. The consultation closed on 7 September and this feedback statement summarises the main points raised and the resulting decisions taken by the Coalition Group.

1.3 There were 59 responses to the consultation, representing a wide range of stakeholders and a broad spectrum of views. The revisions to the Wates Principles reflect the conclusions of the Coalition Group based on the balance of responses, recognise that the UK's large private companies have different management and ownership structures and acknowledge that a one-size-fits-all approach to corporate governance is not appropriate. Equally the aim of the Coalition Group was to avoid a formulaic, compliance-driven approach to explaining the governance practices within companies.

1.4 The Wates Principles offer flexibility for companies to explain the application and relevance of their corporate governance arrangements. Companies are best able to determine the right approach to demonstrate the effect of their governance actions, dependent on their particular circumstances. In response to the comments received in response to the consultation, the supporting Guidance has been improved and also includes links to other sources of help.

1.5 The four main issues considered by the Coalition Group were:

- whether the Principles were appropriate;
- whether the Guidance was useful and whether it could be improved;
- whether 'Apply and Explain' was the right approach; and
- how the Wates Principles linked to other new reporting requirements set out in The Companies (Miscellaneous Reporting) Regulations 2018 (the Regulations).

[1] Department for Business, Energy and Industrial Strategy, *Corporate Governance Reform: the Government response to the Green Paper consultation* (2017), p.40.

1.3 Overall, the majority of responses thought that the Principles covered the main governance issues and were pitched at about the right level to meet the needs of a diverse group of companies. A small number of responses disagreed with the approach taken and felt that the Principles would have little impact.

1.4 Some responses felt that large private companies should follow the UK Corporate Governance Code (the Code) or other codes, and others raised concerns in relation to a lack of prescriptive reporting requirements.

1.5 The majority of suggestions were in relation to the supporting Guidance. Many felt that the Guidance as drafted could be improved as it was too discursive. Respondents felt that large private companies would benefit from more specific guidance on how companies might apply the Principles or what might constitute good practice.

1.6 Other respondents felt that there was a lack of reference to the importance of considering environmental and social issues throughout the Guidance. These views were particularly expressed in relation to Principles One, Four and Six.

1.7 There were differing views regarding 'Apply and Explain' in relation to the Principles. Some respondents felt this was a higher bar than the Code's approach of 'Comply or Explain' Provisions, whereas others felt that it was a lower bar, and would not increase transparency. Other responses noted the different approach compared to the Code and proposed that both should take the same approach.

1.8 The revisions made in light of these issues, along with more specific points made in relation to each consultation question, can be found in the body of this feedback statement.

Summary of responses

1.6 The FRC received 59 responses to the consultation. Copies of all responses, except for those that respondents asked to be kept confidential, are available on the FRC website. A breakdown of the public responses is detailed in the table below. Interestingly there was one international response from the IC-A (Instituto de Consejeros-Adminstradores) – the Spanish Institute of Directors.

Public respondent by type	Total
Business	7
Representative bodies	15
Advisors	13
Civil society organisations	8
Individuals	5
Investors/investor organisations	3
	51

Next Steps

1.9 The Wates Principles offer large private companies a framework when complying with the Regulations that apply to accounting periods beginning on or after 1 January 2019.

1.10 The Coalition Group, supported by the FRC, will continue to meet and work to promote the Wates Principles. It will identify good practices and make any necessary adjustments that may be required after monitoring how reporting against the Principles develops.

2 FEEDBACK RECIEVED

Q1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

Q2. Are there any areas in which the Principles need to be more specific?

2.1 The consultation did not ask specific questions about each Principle. Therefore, when responding to these two questions many took the opportunity to suggest ways in which each Principle or the supporting Guidance could be improved.

2.2 The majority of responses, including almost all of the businesses that responded and many advisors, thought that the Principles and the Guidance addressed the key issues of governance for large private companies, recognising that the Principles needed to be broad enough to deal with different structures and shareholdings.

2.3 However, many responses suggested specific amendments to either the Principles or, in most cases, the supporting Guidance. Others dealt with wider issues. For example, some commented that they felt the Regulations needed to be amended to change the thresholds for reporting, while many also questioned whether subsidiary companies should be required to report on their own governance rather than at a group level.

2.4 Other comments stressed the need to ensure that directors were mindful of their duties under section 172 of the Companies Act 2006, and that the Wates Principles should not seek to amend them. In line with this it was suggested that the Wates Principles should clarify that they were not interpreting requirements within the Companies Act 2006.

Action taken

Recognising that the Wates Principles would benefit from additional information regarding the relationship between the Principles and the Regulations, amendments have been made to the Introduction. The relevant extract of the Regulations, along with section 172 of the Companies Act 2006 (directors' duties), has been included in the Wates Principles. The Introduction clarifies that the Wates Principles do not override or interpret directors' duties to promote the success of the company for the benefit of its members as a whole.

The Introduction also reiterates that when reporting against the Principles, cross-referring to reporting against the legislation is encouraged; this is supported by the Department for Business Energy and Industrial Strategy's FAQs.

Subsidiaries: The penultimate paragraph of the Introduction reiterates that subsidiaries are required to report under the legislation but notes that referral to a parent company's corporate governance statement may be sufficient if it deals with the governance arrangements relevant to the subsidiary.

2.5 A number of respondents felt that the draft Principles did not recognise the importance of environmental and social issues, noting that such issues could impact on the long-term success of companies. These points were made broadly but especially in relation to Principles One, Four and Six.

2.6 In addition, some respondents (including employee representatives and civil society groups) suggested that Principle One or Principle Six should include the three methods of employee engagement included within the Code.

Action taken

The Guidance to Principle Four now advocates developing risk management systems to support informed decisions relating to material environmental, social and governance matters such as climate change, workforce relationships, supply chains, and ethical considerations

The Guidance to Principle Six now has a sub-section on 'workforce engagement' which encourages formal and informal engagement with management. In addition, there is also a reference to the FRC's Guidance on the Strategic Report, which offers more support in these areas.

2.7 Comments given in response to questions 1 and 2 also related to individual Principles and are, therefore, included below.

Principle One: Purpose

2.8 Several responses explained that due to the nature of private companies it is often the founding member who sets the company purpose; therefore, in some cases the board will develop the purpose not set it.

2.9 There were also a number of comments noting that the board should act with integrity, lead the company and set the tone from the top, and that these two important points were not dealt with within the draft Principle One.

2.10 Some respondents felt that wider stakeholder issues should not be dealt with in Principle Six alone, but follow the approach taken in the Code by considering stakeholders under each Principle.

2.11 A number of responses suggested that culture was a key issue and that it would be helpful to consider how culture might be monitored.

Action taken

Principle One has been amended to include both 'purpose and leadership', and also acknowledges that the board both develops and promotes the purpose.

The Guidance now clearly states that directors should act with integrity and set the tone from the top. The importance of dialogue with all stakeholders is promoted more broadly throughout the Principles, but the Coalition Group agreed that it was still important to retain Principle Six.

The Guidance also offers suggestions on how to monitor culture and reinforces that boards should be able to demonstrate how sharing of company purpose and values has impacted on the company.

Principle Two: Composition

2.12 To achieve an effective board many of the responses suggested that the role of the chair and chief executive be separated in line with the Code. Some responses suggested that many private companies already took this approach, and this was beneficial particularly when there was a dominant shareholder within the company.

2.13 Other respondents also discussed the importance of engaging independent non-executive directors, who offer independent challenge, and bring additional skills to the board. It was argued that large private companies should be encouraged to introduce more independent non-executives to their boards.

2.14 Promoting diversity within board and senior management positions was an important issue for many respondents. Concerns were raised that the Guidance only listed some of the protected characteristics within the Equalities Act 2010 and could be misleading as drafted. Many suggested that there should be reference to the Hampton-Alexander Review and other government or independent reviews of board diversity.

2.15 To ensure that matters were carefully considered some responses thought that boards should delegate matters such as audit, risk and remuneration to a sub-committee.

2.16 The importance of succession planning, training and development were suggested as appropriate ways to improve board performance, along with the introduction of regular board evaluations.

Action taken

Changes have not been made to Principle Two, but the heading has been amended to Board Composition. The Guidance has been enhanced in the following ways:

- The Coalition Group agreed that in many cases it would be appropriate to separate the role of the chair and chief executive. Some flexibility is needed to account for the diverse range of private companies. Accordingly, the Guidance now suggests that companies should consider separating the roles.

- A similar approach is taken to independent non-executives. The Guidance promotes the benefits of this role but does not require large private companies to engage them.

- The size, structure and nature of companies will also determine whether sub-committees are necessary.

- The Guidance now refers to the characteristics within the Equalities Act 2010 and links to the Act for more information. The Guidance has also been updated to suggest that diversity policies should be aligned to company strategy and consideration given to reviews such as those by Hampton-Alexander.

The Coalition Group agreed that board evaluations are a useful tool to assess the effectiveness of a board and the Guidance explains that they should be regularly undertaken. It was not felt necessary to specify how often such evaluations should be undertaken.

Principle Three: Responsibilities

2.17 Many responses felt that the Guidance could be sharpened up and made more practical. It was also noted that there was duplication with the Guidance for Principle Two.

2.18 Some responses commented that it was both the board and individual directors who were accountable, and this should be made clearer.

2.19 Questions were raised about what was meant by ‘terms of reference’ within Principle Three and whether this was entirely necessary.

2.20 Others asked for more detail on governance policies and practices which might support the board in discharging its responsibilities.

> **Action taken**
>
> The title of the Principle has been amended to 'Director Responsibilities' and the content amended to ensure that individual directors are aware of their accountability.
>
> The Guidance suggests that there should be agreement on how conflicts of interest cases should be managed. As governance policies and practices are so important to this Principle the Guidance now promotes a periodical review to ensure they are fit for purpose.

Principle Four: Opportunity and Risk

2.21 Most comments in relation to this Principle focused on risk, but it was noted that the Guidance was weighted towards risk rather than opportunity.

2.22 In terms of risk, it was felt that non-financial and reputational risks should be explicitly included within the Guidance. Almost all civil society organisations considered that environmental and societal issues had not been effectively covered.

2.23 Some respondents argued there should be a requirement for an internal audit function, while others noted that this was not a legal responsibility and therefore not necessary.

> **Action taken**
>
> The Principle remains the same, but the Guidance has been split into sections on Risk, Opportunity and Responsibilities. The Opportunity section suggests there should be 'processes' for the identification and consideration of opportunities for innovation and entrepreneurship.
>
> The Coalition Group felt that a specific reference to an audit committee was not required, instead referring to financial, non-financial and reputational risk.
>
> The revised Guidance also deals with emerging risk and principal risks as described in the FRC's Guidance on the Strategic Report.
>
> The first bullet point under 'Responsibilities' has been expanded to deal with material environmental, social and governance matters. As with Principle Three, the Guidance notes the importance of monitoring and reviewing systems.

Principle Five: Remuneration

2.24 Although this Principle had a specific question in the consultation, relevant comments were also provided under questions 1 and 2.

> **Q4. Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken into account in setting directors' remuneration?**

2.25 The responses to this Principle were split between those wishing to see greater transparency along with a specific disclosure requirement and others seeking no change to the draft text, with a small number suggesting that a Principle on remuneration was not necessary for private companies.

2.26 Of the responses that did not suggest full disclosure of pay or the remuneration policy, some suggested that the guidance could be enhanced to suggest how remuneration could be better linked to success; others suggested the Guidance could offer help in consideration of the wider workforce.

2.27 It was also noted that many subsidiary companies would not have the ability to make decisions on remuneration of the board and therefore such companies may not be able to apply this Principle.

Action taken

The Principle is unchanged.

The Coalition Group has been mindful of striking a balance between the distinctly different views in relation to remuneration.

The Guidance suggests that remuneration should be linked to the achievement of company strategy, and there is also discussion of reputational risks that result from excessive rewards.

The Guidance is aligned with building trust and suggests consideration of increasing transparency in relation to remuneration policies.

The Guidance also considers the use of a committee and makes explicit reference to how subsidiary companies might explain their application of this Principle.

Principle Six: Stakeholders

2.28 Along with the general comments relating to this Principle there were two specific questions on stakeholder engagement.

Q5. Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?

Q6. Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?

2.29 Many views were expressed which considered the importance of engaging with shareholders but also wider stakeholders including the workforce. A small number of responses stated that it was their position that workers should sit on boards.

2.30 Respondents cited recent changes to the Code requiring additional reporting on stakeholder engagement as justification for requesting additional changes to this Principle. These included environmental and social matters and emphasising the importance of dialogue with the workforce.

2.31 Businesses raised some concerns that confidentiality could be risked if they were required to disclose detailed information to wider stakeholders.

2.32 Some responses suggested that Principle Six should be split into two Principles – one on Stakeholder Engagement and one on Workforce Engagement. Alternatively, a similar number suggested that there should not be a dedicated Principle on stakeholders, but such matters should be dealt with as part of all the other Principles.

2.33 Several responses were concerned that the draft Principle did not explicitly require companies to explain how their engagement has impacted on board decision-making. Civil society organisations requested that companies should be required to comment on such issues as climate change, modern slavery and international environmental standards.

2.34 Although a number of responses did not suggest explicit disclosure requirements some felt that the Guidance would be improved if it offered suggestions as to how to explain the application of the Principle.

Action taken

When considering the feedback as a whole it was agreed that the title of Principle Six should be changed to 'Stakeholder Relationships and Engagement', as this was a better representation of the aims of the Principle.

The Principle has been slightly amended and refers to both stakeholders and specifically the workforce (with a broad definition of the term, as noted in Principle One). This approach is mirrored in the Guidance where there is a specific section on the workforce.

The Coalition Group considered the requests to propose ways of engaging with the workforce within the Guidance however, a balanced approach was taken by referring to the FRC's Guidance on the Strategic Report which includes reference methods of engagement.

The Guidance is also more explicit in referring to a company's development of both informal and formal channels to engage with the workforce.

Along with making an explicit reference to the workforce, the Guidance also points out that regulators, governments, pensioners, creditors and community groups may also be included in some circumstances.

Responses to the remaining questions

Q3. Do the Principles and Guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

2.35 This question had the fewest responses, and many included specific references under other questions. As discussed under Question One, many responses felt that the Principles were flexible enough to be achievable for the many different types of large private company.

2.36 A number of responses discussed the thresholds set out in the legislation and considered whether the approach taken was the right one.

2.37 Many comments were received asking whether subsidiaries were required to report under the Regulations, and in doing so discussed the complexities of group structures. Several responses explained that subsidiaries would not always have a typical board make-up. In such cases it would be difficult to follow the Wates Principles.

2.38 A number also commented that the way the Regulations is drafted meant that those groups that are made up of subsidiaries would be required to report whereas those with divisions or branches would not.

2.39 Other comments included one which stated that good governance does not consider company structures and the Principles could be followed by any company.

Action taken

The Regulations have been enacted by Government and the Coalition Group is unable to make changes to them. However, the introductory section of the Wates Principles links the Principles and the Regulations more closely making it easier for companies to cross-refer to disclosures made. The Guidance also makes it clear that groups should consider how they report on the governance of subsidiary companies to enable cross-referral.

Q7. Do you agree with an 'Apply and Explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?

2.40 The introduction to this feedback statement explains that this issue generated wide-ranging responses. Some felt 'Apply and Explain' was the right approach for a diverse set of companies, while others thought it should be 'Comply or Explain' in line with the Code. In addition, there was inconsistency in the interpretation of 'Apply and Explain' – some responses thought it was a higher bar than 'Comply or Explain', while others thought it was a weaker approach.

2.41 The Coalition Group has considered this further following the comments made and agrees that 'Apply and Explain' is the best approach for a diverse group of companies. It allows flexibility to report and as the Principles are broad without specific reporting requirements it is right that companies should consider the application and explain their approach in relation to individual circumstances.

2.42 It should be noted that UK premium-listed companies are subject to the Financial Conduct Authority's Listing Rules. These rules require companies to make a statement of how the Principles set out in the Code have been applied in a manner that shareholders can evaluate. Therefore, this approach is not new, and the Code clarifies that the application of the Principles should be explained.

Action taken

As part of the introductory section to the Wates Principles, additional information is given on how to report against the Principles on an 'Apply and Explain' basis. This section explains that the approach is not new as UK listed companies are required to apply the Principles within the Code.

Q8. The Principles and the Guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and Guidance would encourage good practice?

2.43 Around two thirds of respondents answered this question. Many felt that it was important that robust monitoring would be an incentive for good corporate governance, and it would ensure that the Wates Principles maintained a high-profile over the coming years.

2.44 Added to this, it was felt that without some form of monitoring or an appraisal of the quality of the reporting it would be likely that many companies reverted to 'boiler plate' reporting. This was countered by views that felt a prescriptive approach including 'naming and shaming', would also encourage box-ticking rather than encouraging companies to implement systems that lead to real cultural change.

2.45 Some promoted the benefits of raising the profile of the Wates Principles, including highlighting examples of best practice before a decision is made on more active monitoring after a year or two of reporting.

2.46 Others noted that the Wates Principles were part of a package and that the requirement was to report against the Regulations and therefore there was no need for specific monitoring of the Wates Principles.

2.47 Several of the responses considered the cost of monitoring and who might undertake the role. A majority thought that this could fall to the FRC but noted the cost and resourcing implications, alongside acknowledging that the role of the FRC would not be known until after the Kingman Review reports at the end of 2018.

2.48 Others felt that monitoring governance would fall to company auditors. They currently have a role in checking that what is reported about governance is consistent with their knowledge of the company. Alternatively, other independent third parties may have a role, such as audit firms, trade associations or press.

Action taken

The Coalition Group wants the Principles to be a tool for companies to consider their approach to corporate governance and think about what they have done well and where there is room for improvements.

In the Foreword, James Wates explains that the Coalition Group will continue to meet and work together to promote the Wates Principles, and once reporting begins in 2020 it can develop an understanding of trends and best practice.

The Coalition Group will consider any additional monitoring during this process.

Q9. Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted verses publicly listed companies?

2.49 Of the 28 responses to this question over half felt that the balance was about right, noting that ownership and management structures vary dramatically, and therefore additional flexibilities are necessary. This is compared to publicly listed companies that are subject to the separation of shareholders from the daily decision-making process.

2.50 Many of the respondents who thought that the balance was right qualified their views subject to the suggestions they had made to the Principle or associated Guidance.

2.51 There were some respondents who felt that the impact of large private companies is equal to that of public companies and therefore all companies of a significant size should be subject to the same or very similar requirements. In such cases it was suggested that the Code should be applied in full or with minor adaptations to large private companies.

2.52 Several other responses also stated that there were other methods of reporting, for example, against the QCA Code, or AIM rules. Large private companies could also follow the Code voluntarily.

Action taken

The Coalition Group considered the points made and, as explained above, and has made a number of changes to the Principles and the Guidance. It believes that the Principles offer a proportionate approach to corporate governance, suitable for the largest private companies.

Q10. We welcome any commentary on relevant issues not raised in the other questions.

2.53 There were over 20 responses under this heading, some of which have been commented on or dealt with as part of other questions, for example whether the legislation sets the bar at the right level, whether subsidiaries should report, and consideration of reporting against other codes as noted in the response to Q9 above.

2.54 Other views suggested that wider stakeholders were not sufficiently dealt with and that diversity policies needed to be more prominent within the Guidance.

2.55 Some felt that the Principles were too general and therefore did not achieve their goal and may not be a success. In a similar vein, there was a suggestion that the Principles should be linked more clearly to specific types of company, for example a subsidiary or a family business.

2.56 Some responses felt that the Wates Principles would not improve governance and would have to be revisited in the future.

2.57 There were also some requests for a template to be available for companies to follow when reporting.

2.58 Some responses sought assurance that following the Wates Principles would be appropriate to meet the legal requirements pertaining to following a code.

Action taken

The Coalition Group has considered the wide-ranging views expressed to all the questions and other general comments made. In doing so it has tried to strike a balanced approach, setting broad Principles that the majority of large private companies should be able to apply to their management structures. The improved Guidance and references to additional guidance and legislation should support explanations.

The Coalition Group considered a reporting template, but on balance thought that this would lead to a 'tick-box' approach.

The Department for Business, Energy and Industrial Strategy's FAQs will help those respondents who requested additional guidance on the legislation.

The Chairman and Coalition Group acknowledge that this is a long-term effort and the Wates Principles are a start.

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

+44 (0)20 7492 2300

www.frc.org.uk