

IC-A's REPLY TO The Wates Corporate Governance Principals for Large Private Companies Consultation Document

FRC - June 2018

EXECUTIVE SUMMARY

The Instituto de Consejeros-Administradores" (IC-A), the Board Directors' Association based in Spain, is pleased to contribute to the project that Mr. James Wates CBE is leading on the development of corporate governance principles for large private companies in UK with the hard work of the Coalition Group and the Financial Reporting Council.

Large private companies have a size and dimension that requires a high level of corporate governance as this benefits the society, the shareholders and the stakeholders.

IC-A has a great experience on the development of good corporate governance principles for unlisted companies and a practical experience based on more than 10 years of implementation in Spain of IC-A's Principles of Good Corporate Governance for Unlisted Companies and Family Businesses.

CREDENTIALS

In 2005 we developed IC-A's "[Principles of Good Corporate Governance for Unlisted Companies and Family businesses](#)" and on 2008 it developed IC-A's [Self-Evaluation Questionnaire On Good Corporate Governance For Unlisted Companies](#).

These principles are used in more than 80 countries worldwide in the training of Board Directors. More than 750 Counselor trainers from the International Finance Corporation, IFC (belongs to the World Bank and OECD) have been trained using these materials.

This Code for unlisted companies and family companies served as the basis for the book on "Corporate Guidance and Principles for Unlisted Companies in Europe". It has also been the basis of the codes developed by different institutes of Directors since 2010 in countries like UK, France, Belgium, Slovenia, Finland, Mauritania, Trinidad and Tobago and Bahrain, among other.

The lessons learned through the implementation of the "Principles of Good Corporate Governance for Unlisted Companies and Family Businesses" in Spain showed us that good governance help companies' sustainability.

Taking into consideration that unlisted companies in Europe represent aprox. 70% of the GDP and employment, to extend these principles to Europe it would be good for the economy and society.

ecoDa (the European Confederation of Directors Associations based in Brussels representing more than 55,000 Directors), under IC-A's presidency, formed a working group to create the first European Code for Unlisted Companies.

The European Code of Corporate Governance for Unlisted Companies ("Corporate Guidance and Principles for Unlisted Companies in Europe"), which was developed by ecoDa, was presented at the European Parliament in 2010 by ecoDa's President (Mr. Juan Alvarez-Vijande).

Also in 2010, on the occasion of the first European Corporate Governance Conference held in Spain (Madrid), the European Commission introduced corporate governance principles for listed companies and for the first time principles for non-listed companies. This Conference was organized by the IC-A and the Spanish Ministry of Economy and Finance.

On top of corporate governance codes for unlisted, IC-A has developed the following codes:

- "Principles of Good Corporate Governance"
- "Principles of Good Corporate Governance for Unlisted Companies"
- "Guide for the Incorporation to a Board of Directors: Non Executive/ External Board Director"
- "Practical Guide for the Board of Directors"
- "Good Governance Practical Guide for NGOs: Public Utility Associations and Foundations of IC-A"
- "The Role of the Senior/ Lead Independent Director"
- "Compliance and the Board of Directors: Practical Guide"

CONSULTATION QUESTIONS

Our suggestions are based on the document "[Wates Corporate Governance Principles for Large Private Companies](#)" published by FRC on June 2018.

Introduction

As "The Wates Corporate Governance Principles for Large Private Companies" is a voluntary code, we suggest more detail on the advantages to implement it for the society, shareholders and stakeholders.

Even though the Wates principles do give a brief mention to the benefits that the Principles imply we suggest to be more explicit specifying the following main reasons for implementing good corporate governance in private companies:

- Increases company value
- Increases shareholders' shares value
- Increases company attractiveness for potential investors
- Help to get better finance conditions
- Mayor return for stakeholders
- Help company sustainability
- Help to manage family issues in family business
- Better protection of minority shareholders
- Better management of conflict of interest
- Increase professionalism
- Better access to public markets

On top of that, we would like to remind that, in private companies, it is of special relevance given that shareholders generally have less degrees of freedom to sell their shares. They are to some degree something like "captive shareholders" and good governance is especially important for them.

As far as we understand, it seems that large private companies can use these principles or others but the reporting will be mandatory for large private companies.

Even though it seems that large private companies in the UK will have the freedom to use other governance principals, it should be more clearly stated that the Wates Principles are the recommended ones for UK's large private companies.

In terms of reporting, we suggest to set up a standard reporting model where the key questions are included, compelling all large private companies to reply to the same key questions. To reply to the same key questions help companies to remember and give thought to fundamental issues.

We also recommend to take into consideration the advantages of an electronic reporting model.

At the same time, it should be clear which is the entity (FRC? or other) that is in charge of monitoring large private companies' annual reports.

Remarks related to the specific questions included in the Document:

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

In addition to the introduction remarks that we have made, from our point of view, as these private companies are large, we recommend to include:

- In principle one, the relevance of an explicit agreement among shareholders about clarity of purpose and mission, grand strategy and key policies is well described and it's extremely valuable to facilitate good governance.

In addition to that and in relation to the board of directors, we recommend for the recommendations to include that the primary role of the board is to lead the company at top level.

- The board of directors' primary functions to be performed should be clearly defined and included. **This is a very good lesson from field experiences.** We cover this in more detail in question 2.
- We suggest to make the Principles more explicit regarding board composition, board organization and the non-delegable fundamental responsibilities of the board. We detail our suggestions in question 2, Principle 2.

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

Principle 1.

- To add that the board should lead the company at top level.

The Board will set the pace and conduct of the company, integrally and at top level, subject to whatever may be reserved to the General Shareholders' Meeting. This leadership will refer to all that is entailed in the development and achievement of the ultimate business aims and to how to achieve these in terms of transparency, ethics, responsibility and observance of the law.

Principle 2.

- As they are "Large Private Companies" specifically add the following to board composition:
 - The value of incorporating independent external board directors for large private companies.

This is particularly relevant when not all shareholders are represented at board level.

- Expand guidelines for board organization to include:
 - To recommend the creation of an Audit Committee, chaired by independent director.
 - To recommend the creation of a Nomination and Remunerations Committee, chaired by independent director.
 - To consider the potential appointment of a Senior Independent Director. This is relevant in all cases and, particularly, in the cases of Executive Chairman.
 - This could be done gradually.

Principle 3.

- To add as a reference for board effectiveness that the Board of Directors of a large private company should perform the following **primary functions that can't be delegated**:

- To establish the Corporate Strategy:

The Board is responsible for drawing up the Mission and Values that will guide the company and its ultimate aims, and will also convey that Mission and values to those responsible for Management.

In particular, it will approve Corporate Strategy and take an active part in its study and definition. It will also hear and approve strategic decisions (large investments, divestments, mergers and acquisitions or others) as well as annual or plurennial Business Plans.

The Board will also ensure that the plans approved are executed efficiently and stringently in a manner coherent with the strategy defined and with the Values and Missions defined.

- To be accountable to shareholders and stakeholders:

The Board will have the responsibility to serve the legitimate interests and expectations of its shareholders and will be obliged to render account thereto, fully and regularly, and to facilitate the exercise of their rights, ensuring a fair treatment for all shareholders including minorities and foreigners, if any.

The Board will ensure the necessary transparency of relevant elements of information, such as: the financial situation, results, ownership or governance of the company; it will be responsible for the accuracy of information, as well as its presentation, with the frequency and dissemination required. It will fundamentally ensure that shareholders have a true image of the situation and health of the company.

The Board will ensure full respect for the legitimate rights and interests of those persons or groups, stakeholders, that without being shareholders, are

directly or indirectly affected by the behavior of the company. In particular, customers, suppliers, business partners, employees, authorities, competitors and the public in general in matters such as the environment, health or safety. It will also ensure that specific policies are established to relate to these groups.

It will also ensure that active communication is maintained, adapted to the needs of each of the groups or individual persons in question.

- To supervise company performance and sustainability:

The Board will also supervise progress of the company in terms of performance of its plans, profitability, efficient management, compliance, viability and development potential.

It will permanently assess the different risks that affect the company and its sustainability and ensure that these are given the necessary consideration.

Accordingly, it will ensure that the necessary audit and control resources and procedures, both internal and external, are available and that they are applied effectively.

- To supervise the executive:

The Board is responsible for the selection and designation of the Chief Executive, the establishment of his/her attributions and autonomy of decision and the policies and standards to be adopted in his/her relations with the Board (information, frequency of meetings and annual review calendars for specific issues). It must also ensure that succession plans are permanently available. If necessary, it will be responsible for his/her cessation and total or partial substitution.

The Board will approve the specific objectives and targets of the Chief Executive and will assess the performance of his/her functions and their achievement.

The Board will define the specific salary scales and amount of remuneration of the Chief Executive and, following assessment of his/her performance, will approve the amounts to which he is entitled annually or plurianually.

At the same time, the Board will approve proposals for the appointment and cessation of Key Managers, as well as assessment and remuneration policies for these. It will also see the result of his/her assessments to estimate his/her capabilities and potential.

- To manage the Board itself:

The Board will be responsible for its own management, in the broad meaning of the word, subject to the attributions reserved for the General Shareholders' Meeting.

First of all, it must ensure that the Board is adequately composed and propose the designation and, as the case may be, removal of Board Directors to the General Meeting. Accordingly, it will select and identify persons with the appropriate professional and personal profile and will also ensure the maintenance of a balance of power on the Board that genuinely responds to the interests of all shareholders.

The Board will establish its own internal structure, particularly the functions of Chairman and whether he will or will not be a person other than the Chief Executive. It will also define the Committees to be set up and their composition.

The Board will determine its own working procedures. These will cover the frequency and duration of Board meetings and meetings of each of the Committees and the basic contents thereof throughout the year. A more active participation of Boards is a generalized trend.

The Board will also lay down its own remuneration criteria and policies, and will ensure that this obeys the higher interest of its shareholders.

Finally, the Board will establish a discipline for evaluation of its own management, which will be performed regularly, using preferably external or internal resources.

- To add the importance of an induction (or education) process for board directors to explain or clarify functions, duties and responsibilities.

3. 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?

Other potential ownership structures could require a more detailed guidance. Specifically family business and private equity.

In any case and for all large private companies, it has special relevant that the board of large private companies to a fair treatment of the “captive shareholders” when taking decisions. To remember this is relevant.

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

To add and to emphasize the relevance of the shareholders’ meeting as the entity to approve board directors’ remuneration.

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

No relevant comments.

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

No relevant comments.

7. **Do you agree with an "apply and explain" approach to reporting against the Principles? If not, what is a more suitable method of reporting?**

Yes.

8. **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?**

We suggest to set up a standard reporting model where the same key questions are included compelling all large private companies to reply to the same critical key questions. To reply to the key questions help companies to remember and give thought to fundamental issues.

We recommend to take into consideration the advantages of an electronic reporting model. By using an electronic model the entity responsible of monitoring could make periodic reports on updated strengths and weaknesses of private large companies.

Finally, in the principles or in other related place, it should be more clear which entity will be responsible for monitoring (FRC? or other).

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

There will be a reasonable balance if the principles are expanded in line with the comments made.

10. **We welcome any commentary on relevant issues not raised in the questions above.**

We also suggest to include an annex with the legal duties and responsibilities required for a board director of a private company in the UK.

This will help board directors to be aware of all legal requirements for a board director of a private company in the UK.



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