

February 28, 2018

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

Re: Consultation on a revised UK Corporate Governance Code

Dear Ms. Horton:

The Association of Corporate Counsel (ACC) appreciates the opportunity to comment on the Financial Reporting Council's (FRC) consultation on revisions to the UK Corporate Governance Code and Guidance on Board Effectiveness. We applaud the FRC's direction to boards and chief executives to consider how they are promoting integrity and good corporate culture within their organisations.

We wish to raise an issue often overlooked in discussions on corporate culture: the role of the general counsel and the legal department in setting an appropriate "tone from the top" and supporting an ethical "mood in the middle." Our comments will focus on this topic, and we ask the FRC to consider making a recommendation for boards to consider this issue as part of its Guidance on Board Effectiveness.

As noted in the consultation document, corporate culture has been studied by the FRC and other organisations as part of an effort to enhance public trust in businesses after the financial crisis of 2008. One of the "key observations" from the FRC's "Corporate Culture and The Role of Boards, Report of Observations," was that "[t]he values of the company need to inform the behaviours which are expected of all employees and suppliers. Human resources, internal audit, ethics, compliance,

and risk functions should be empowered and resourced to embed values and assess culture effectively. Their voice in the boardroom should be strengthened.” This observation is no less true of a company’s legal department.

As the leading global bar association for in-house counsel,¹ ACC’s perspective on the issue of corporate culture is unique. Last year, we authored a white paper, *Leveraging Legal Leadership: The General Counsel as a Corporate Culture Influencer*, sharing our perspective on the legal department’s role in supporting corporate culture.² Although corporate culture is not typically linked to a company’s general counsel and legal department, we believe the failure to draw that link may prove short-sighted on the part of corporate management, the board, and other stakeholders. Given the importance of the general counsel in matters of ethics, compliance, corporate governance, and risk and reputation management, the general counsel should be a key ally and partner in establishing a corporate culture that supports corporate performance without compromising ethical behaviour or legal and regulatory compliance. Recently, the National Association of Corporate Directors (NACD) agreed with this view, recommending in its Blue Ribbon Commission Report on Culture as a Corporate Asset³ that directors assess whether the chief legal officer/general counsel and other risk management officers are well-positioned in management and in relationship to the board to support an appropriate culture.

Below we discuss why the general counsel and the legal department are important to considerations of corporate culture; how the United Kingdom is lagging in indicators of general counsel who are well-positioned to influence corporate culture; and how a recommendation from the FRC can help establish best practices in this regard.

¹ ACC represents the business and professional interests of more than 42,000 members employed as in-house counsel by more than 10,000 organisations in over 85 countries.

² The white paper and other related materials are available at acc.com/governance.

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³ The NACD is a US-based membership organisation for members of corporate boards, similar in mission to the UK Institute of Directors. The Blue Ribbon Commission Report on Culture as a Corporate Culture can be found at:

<https://www.nacdonline.org/files/NACD%20BRC%20Culture%20as%20Corporate%20Asset.pdf>.

I. The importance of the general counsel to corporate culture

Twenty or thirty years ago, a statement that a company's corporate culture is linked to its general counsel and the legal department would have left many in the business world scratching their heads. In-house lawyers were seen as technicians who handled simple legal tasks and managed the outside counsel who performed the more sophisticated legal work that the business depended on. However, the past few decades have seen an evolution of the role in-house counsel play in business, and the stature and prominence of the general counsel role has increased. These two changes taken together have resulted in a corporate atmosphere where the general counsel and the legal department can act as corporate culture influencers.

A. Evolution of the role of the general counsel

Regulatory and business demands over the past few decades have expanded the need for general counsel to be influential within their companies. In the 1990s, companies began to approach regulatory compliance and ethics in a more systematic way, largely in response to governments incentivising the creation of corporate compliance programs to prevent and detect violations of the law. Although some companies have compliance functions that are separate from the legal department, many of the activities mandated by compliance programs require legal analysis, and any effective compliance program requires coordination with the general counsel.

The emphasis on the general counsel's role in ethics and compliance has fueled the position's growth in professional stature and has increased the general counsel's involvement in decisions made by executive management. Even outside of compliance concerns, legal and regulatory issues are increasingly central to the implementation of sophisticated business strategies. For example, protecting innovation requires understanding intellectual property law; overseas expansion requires knowing the employment laws of other countries; advances in data

analytics require knowledge of data privacy laws. Where outside counsel used to be the primary legal advisers to the CEO, general counsel now fill that role, particularly in large multinational and/or publicly held companies. As legal departments have evolved and attracted top-level talent below the general counsel, the general counsel has carved out more time to consider legal, regulatory and even ethical issues concerning core business operations and influence the direction of corporate strategy.

Numerous books, articles and academic studies have chronicled this evolution in the role of in-house counsel. While many focus on this as a US-based phenomenon, the same transformation has occurred among in-house solicitors in the United Kingdom over last 10-15 years. As noted in a 2014 report on in-house counsel prepared by the Solicitors Regulation Authority (SRA), “[t]he US model of general counsel/in-house counsel has become the dominant mode of producing company legal services,” and “has been exported to the UK and most of the rest of the world.”⁴ A benchmarking study of FTSE350 legal departments released by the Law Society of England and Wales in 2016 noted, “[b]usinesses are increasingly recognising the importance of general counsel to their success. The function is trusted and general counsel are increasing their influence”⁵ Unlike some countries in Europe where in-house counsel are still marginalised within the business and legal communities, in-house solicitors in the United Kingdom are positioned to have great potential impact on corporate culture.

B. The legal department’s ability to influence corporate culture depends on the general counsel’s position within the company

Although in-house solicitors in the United Kingdom have enjoyed a similar increase in stature and influence to what has occurred in the United States, the

⁴ “The role of in-house solicitors,” Solicitors Regulation Authority (2014), page 14. Available at: <https://www.oxera.com/Latest-Thinking/Publications/Reports/2014/The-role-of-in-house-lawyers.aspx>

⁵ The GC350: Benchmarking study for the in-house community: Wave 1, Law Society of England and Wales (2016), page 3. Available at: <http://www.lawsociety.org.uk/support-services/research-trends/growing-influence-of-gcs-revealed-by-law-society-report/>

ability to impact corporate culture cannot be fully realised unless the general counsel (and by delegation, the legal department) are well-positioned within the company. For example, when members of the executive team regularly consult with the general counsel on new strategies and products, the general counsel can more effectively ensure that the company's actions are consistent with its legal, regulatory and ethical requirements. A management team that marginalises the general counsel (and therefore the legal department) not only loses out on this risk-management perspective, but also sends a company-wide message that culturally, legal risks, ethics, and compliance are likewise discounted. To avoid marginalising the general counsel and legal department in this way, companies should have the general counsel included as part of the executive management team that reports directly to the CEO and the general counsel should have regular access to the board of directors, preferably through attendance at board meetings.

The reporting structure of the general counsel position is an important indicator of the influence that the legal department has in the company. The *ACC Chief Legal Officers 2018 Survey*⁶ shows that general counsel who report to the CEO are much more likely to say that the executive team “almost always” seeks their input on business decisions. General counsel who report to the CEO are also significantly more likely to report they “almost always” contribute to strategic planning efforts compared with those who don't. When the general counsel is consulted about business decisions and strategic planning efforts, there is a greater likelihood that those decisions and plans will take into account legal and regulatory risks. Pre-decision consultation helps the legal department fulfil its preventative role within the company and reinforce a culture that manages risk and compliance.

In addition to providing the legal department with requisite influence, having the general counsel report to the CEO is an important part of setting the “tone at the top.” When legal has a seat at the table, it sends a message to the rest of the company that compliance with laws and regulations is a company priority. It also says

⁶ The ACC Chief Legal Officers 2018 Survey is the most recent edition of ACC's annual global survey of chief legal officers, which the survey defines as the highest-ranking legal officer in a company. In this letter, the terms general counsel and chief legal officer are used interchangeably. The ACC survey is available at: acc.com/research.

something about the CEO: that input from legal advisors is valued, and that the CEO's vision for the company emphasises compliance, ethics and integrity.

Similarly, a board of directors that does not have a consistent relationship with the company's general counsel should be a cultural red flag. While the relationship between the general counsel and the board can take various forms, it is important that the general counsel have regular access to the board of directors. After all, the board is the company's fiduciary representative, and the company is the general counsel's client (not the individual members of the executive management team). A relationship between the general counsel and the board of directors enables the board to set the tone for the company's legal, ethical, and compliance culture, and also helps maintain the independence of the legal function. While this does not require every company to employ a direct reporting structure between the general counsel and the board, at a minimum, the general counsel must have a mechanism to bring controversial issues to the board — without prior CEO consent.

Indeed, the SRA recognised the importance of a relationship with the board of directors to in-house counsel practice in its Practice Framework Rules. Guidance Note (viii) to Rule 4: In-house practice, states that "If you are working in-house as the senior legal adviser of a company or a local authority you should have direct access to the board or to the council and its committees, and should try to ensure that your terms of employment provide for such access."⁷

II. General counsel in the UK are not as well-positioned as their global counterparts

The United Kingdom enjoys a strong reputation for the sophistication and quality of its legal industry. In fact, English common law arguably has had the most profound and far-reaching impact internationally of any system of jurisprudence. Yet, when it comes to measuring the influence of its in-house legal department, data

⁷ The guidance note goes on to state: "Direct access' does not mean that all instructions and advice must pass directly to and from the council, committee or board, but you must have direct access where necessary."

suggests that the United Kingdom lags behind its global counterparts. The *ACC Chief Legal Officers 2018 Survey* found that 64 per cent of chief legal officers globally report to the CEO. Given the multiple benefits of a direct-reporting relationship between the CEO and general counsel, this number is too low. But the UK numbers are even lower. When the data in the survey is isolated to just the UK respondents, only 47 per cent identified as reporting directly to the CEO. This suggests that UK general counsel are not as well-positioned as their international counterparts to positively affect corporate culture. The ACC survey also found the indicators of general counsel influence to be lower among UK chief legal officers than the global population of respondents:

- When asked, “how often does the executive leadership team seek your input on business decisions,” 87 per cent of UK chief legal officers answered “sometimes” or “almost always,” compared to 95 per cent of chief legal officers outside of the United Kingdom.
- When asked “how often do you meet with business leaders at your company to discuss operational issues and risk areas,” 90 per cent of UK chief legal officers answered “sometimes” or “almost always,” compared to 98 per cent of chief legal officers outside of the UK.

Surveys focused specifically on the UK market produce similar findings with respect to reporting to the CEO and the overall influence of the legal department. In the Law Society’s survey of 100 chief legal officers from the FTSE 350, just over half reported to the CEO. When it comes to influencing business strategy, 37 per cent of the respondents in the Law Society’s survey report having “no” or “very little” influence over strategic direction, yet it was the number one category over which respondents reported they should have more influence.

With respect to UK general counsel having a role in board meetings, the data is mixed. In the Law Society’s survey of FTSE 350 organisations, just over two-thirds (69 per cent) have a seat on the board/executive board of their organisation. Presumably having a seat on the board means these chief legal officers regularly interact with the board of directors. However, in the ACC survey, which has a

broader range of companies represented, only 54 per cent of UK chief legal officers reported “almost always” attending company board meetings, compared to 74 per cent outside of the UK. By this metric, more than 40 per cent of UK chief legal officers are not benefitting from a consistent presence in the boardroom. This is especially troubling in light of the SRA’s guidance on the importance of access to the board of directors for companies’ most senior legal advisors.

III. The FRC should recommend that boards consider the positioning of the general counsel within a company to have the best influence on corporate culture

Given the role that a well-positioned general counsel can play in reinforcing a healthy corporate culture that values ethics and compliance, ACC believes it is a best practice for general counsel to report to the CEO and have a regular presence in the boardroom. The FRC should incorporate these recommendations into its Guidance on Board Effectiveness to encourage UK companies to adopt these practices and increase the percentage of UK chief legal officers reporting to the CEO and having regular access to the board of directors.

As mentioned above, the NACD recently issued governance recommendations on corporate culture that reflect this view. The NACD Blue Ribbon Commission Report on Culture as a Corporate Asset recommended that directors assess whether the chief legal officer/general counsel and other risk management officers are well-positioned in management and in relationship to the board to support an appropriate culture. Specifically, the report recommended that the board consider the following questions:

- What is the scope of authority for persons holding these positions?
- To whom do they report administratively, and does that differ from the functional reporting relationship?
- How does their budget, staffing and access to information compare to leading practices in the industry or in general?
- How (and how often) do they interact with the board?

The Culture section of the revised Guidance on Board Effectiveness appears an especially appropriate place for the FRC to address this issue. Paragraph 42 suggests that boards should inquire whether management has put appropriate mechanisms in place to implement and embed the company purpose, strategy and values. The inclusion of the general counsel and legal department in crucial business strategy decisions should be part of that process, and FRC should recommend this to boards. Further, FRC could add the legal and risk-management considerations discussed above to their “Questions for boards” and “Questions for boards to ask management” in this section on corporate culture. For example, a question for boards might be: “Is the company structured in a way that supports the consideration of legal and other risk issues in the development of business strategy?” A question for boards to ask management might be: “How is the legal department considering issues of ethics and culture in its legal advice?” And of course, if the general counsel is not a direct report to the CEO and does not have a regular presence in the boardroom, that should be an immediate area of inquiry.

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With the revision of the UK Corporate Governance Code and the Guidance on Board Effectiveness, the FRC can create a new paradigm that encourages companies to consider corporate culture along with other worthy issues like board diversity and stakeholder engagement. As a global leader in both corporate governance and legal systems, the United Kingdom is now presented with the opportunity to be the first government to recognize and support the positive influence of the general counsel and the in-house legal department. We urge the FRC to include consideration of the legal function in its corporate governance revisions to further reinforce the corporate mechanisms that build and maintain a healthy culture.

Sincerely,

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