

UK Corporate Governance Code

Response from the AIC

The Association of Investment Companies (AIC) welcomes the opportunity to respond to the Financial Reporting Council's (FRC) consultation document, '*Proposed Revisions to the UK Corporate Governance Code*' (the UK Code).

The AIC represents 348 investment companies with assets under management of over £160 billion. Investment companies have their shares admitted to trading on public stock markets. The AIC's members are predominantly listed on the Main Market of the London Stock Exchange. Some have shares admitted to trading on the Specialist Fund Segment; others are quoted on AIM.

The AIC's members include UK investment trusts, Venture Capital Trusts, UK REITs and non-EU companies. Our non-EU members are primarily Channel Islands domiciled.

The AIC has responded to this consultation paper representing its members as issuers of shares and owners of assets. Most investment companies do not take day-to-day investment decisions. Instead these functions are outsourced to an external asset manager.

Reforming the UK Corporate Governance Code

The AIC welcomes many of the reforms proposed by the consultation paper. The success of the 'comply or explain' model has been replicated around the world. It is right that this continues to form the basis of corporate governance reporting in the UK.

It is also right that the structure of the revised UK Code is updated to make it shorter and sharper. The AIC supports moving some of the Principles from the current UK Code to the Guidance on Board Effectiveness. The revised format is more fit for purpose. It focuses on the principles of good corporate governance in supporting a company's long-term success and sustainability.

Recognition of the AIC's Code

The AIC is pleased the FRC has recognised '*The AIC Code of Corporate Governance*' (the AIC Code). The AIC Code provides boards of our member companies with a framework of best practice in respect of governance of investment companies.

The AIC Code recognises that investment companies have special factors which have an impact on their governance arrangements. These special factors arise principally from the following features:

- The customers and shareholders of an investment company are the same. Most often, they have no employees. This simplifies stakeholder considerations;
- An investment company board is typically entirely comprised of Non-Executive Directors (NEDs); and

- The company often outsources its day-to-day operations. This includes using an investment manager to manage the investments appropriately within a defined mandate. The investment manager is a more important stakeholder than a typical supplier.

The AIC Code is currently endorsed by the FRC. This allows member companies who report against the AIC Code to meet their Listing Rule obligations in relation to the UK Code.

To retain the FRC's endorsement, which is greatly valued by our members, we will be aligning the AIC Code with the new UK Code. We will commence work on the AIC Code once the FRC has published a final version of the UK Code, which is expected in summer 2018.

Delivering independence and appropriate board composition

The proposed revisions to the UK Code make significant changes to proposed best practice where individual directors serve for significant amounts of time. Specifically, it considers that those serving over nine years should not be considered independent. Underlying this perspective is a view that long service is, of itself, problematic. The AIC disagrees. It considers that having boards with some long-serving directors can be actively beneficial to shareholders. The financial crisis erupted, with major implications for the investment company sector, some ten years ago. It resulted in significant, and sometimes unexpected, challenges for investment companies and their boards. A board able to draw on the experience of directors who have served through such events can benefit from their unique perspectives. This experience can help a board prepare for the next time that market circumstances move into a significantly less favourable, more stressed, part of the economic cycle.

Long service also helps maintain a strong 'corporate memory'. Directors who were involved in significant decisions taken in the past, and understand the reasoning behind them, can draw upon those experiences to improve the quality of future decisions and, in turn, contribute to the long-term success of a company.

The implication within the UK Code is that long-service is, invariably, detrimental to effective corporate governance. This is inappropriate. The AIC **recommends** that the UK Code balances its discussion of tenure by noting the positive contribution that long-service can offer. In particular, it can help boards better serve the needs of their company and its shareholders by providing experience across the business/economic cycle. Not recognising this increases the risk that some investors or proxy agencies will adopt a tick-box approach to long-service which weakens board oversight instead of strengthening it.

The AIC is also concerned that tenure is identified as being a determinant of whether or not a director is independent. This is inappropriate. The current UK Code requires that boards identify each NED it considers to be independent. It states that:

"The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including

if the director... has served on the board for more than nine years from the date of their first election.”

This approach sets out several factors for boards to consider when assessing independence. The primary test is whether the director is “*independent in character and judgement*”. This is an appropriate high-level principle, but it has been deleted from the revised UK Code. The AIC **recommends** this overriding principle is retained. Deleting this principle suggests that independence should be assessed in a more mechanistic, tick-box fashion. This goes against what is at the heart of the proposed revision to the UK Code. That is, that companies should comply with the spirit of the principles rather than a set of rigid rules. Suggesting that independence is not, in its most basic interpretation, about character and judgement undermines ambitions to achieve good governance: it does not enhance it. This basic principle should also be reflected in the revised UK Code.

Length of service is currently one of several indicators for boards to consider when assessing independence. This approach allows companies to form a judgement on whether a NED continues to be independent given the specific circumstances.

The AIC does not agree that lengthy service on a board will, in itself, automatically compromise independence. Instead, the AIC **recommends** that length of service should be considered as part of the board’s wider discussion on composition and diversity. This is a more fitting approach than identifying tenure as a factor that determines independence of character and judgement.

In addition to considering length of service as part of the discussion about appropriate board composition, the AIC **recommends** deleting the final bullet point in Provision 15 (which sets a 9-year threshold for board directors to be considered independent). A specific length of service should not be a threshold which, once crossed, means a director is no longer independent. Long-serving NEDs should not be prevented from forming part of an independent majority, provided they remain “*independent in character and judgement*”.

Principles I, J and K, respectively, encourage companies to think about board composition, succession planning and board evaluation. They aim to ensure board composition is balanced and appropriate.

These principles do not currently recognise that length of tenure may also be a factor in the discussions on board composition and succession planning. The AIC’s Code recognises that it is important to have balance in a board, not only in their skills, but also in length of tenure. It recommends that “*The board should aim to have a balance of skills, experience, length of service and knowledge of the company*”. Including length of tenure in the UK Code as an explicit factor to be considered in relation to board composition and succession planning will deliver diversity in length of service. This will also help address issues of succession planning and diversity. For this reason, the AIC **recommends** that length of tenure be added to Principle J. For more details, see our response to question 8.

The AIC **recommends** that, where a director has served for more than nine years, the board should state its reasons for believing that the individual remains independent in the annual report (as currently recommended in the AIC’s Code). The AIC also **recommends** that NEDs

serving more than nine years are subject to annual re-election (as currently recommended in the AIC's Code). Note, the AIC does not consider that all directors should be automatically subject to annual re-election. Exemptions to this principle, currently allowed for smaller companies should be maintained (see *Creating a proportionate UK Code, Annual re-election*, below).

This approach is similar to Provision 18 which recommends that, when board members are re-elected, boards should set out the "*specific reasons*" why the board member's "*contribution is and continues to be important for the company's long-term success*". This will give shareholders the relevant information to enable them to take an informed decision on whether to re-elect a board member. This also provides shareholders with the final say on board composition.

It is right that companies should continue to follow principles-based tests when assessing and evaluating the independence and composition of the board. This provides an appropriate best practice guideline whilst continuing to ensure the right outcome is achieved.

Were the FRC not to accept the proposal for length of service to be reflected in principles dealing with board composition and succession planning, the AIC **recommends** that length of service should continue to be an indicator to consider when assessing independence. It should not be a threshold test.

Creating a proportionate UK Code

The government has highlighted the need to encourage trade and inward investment by considering how "*regulations could impact on growth and making sure that the cost of regulation is justified by the benefits, and that regulation is consistent and transparent so as to give investors confidence that regulators act in a proportionate way*". The AIC supports this approach. Providing a proportionate regulatory environment will ensure that markets work effectively and investors have the information they require. This approach should be applied, not only to regulation, but also to codes of best practice.

The UK Code should be appropriate for all companies to use. It should apply in a proportionate way that does not unduly burden smaller companies.

The current UK Code contains several exemption provisions for smaller companies. Smaller companies are defined as being "*one that is below the FTSE 350 throughout the year immediately prior to the reporting year*". Smaller companies often find it more difficult to engage with some of their institutional investors or wealth managers. Larger companies tend to get more attention. This may be commercially understandable, but it means that smaller, non-standard companies get less opportunity to engage and explain their position. The actual experience of smaller companies, and the different challenges they face in having their explanations heard, justifies taking a different approach to corporate governance best practice. The AIC therefore **recommends** that the smaller company exemptions are retained. They help to create a proportionate and flexible best practice regime. Each exemption is discussed, in turn, below.

If the FRC does not decide to retain the smaller company exemptions, the AIC **recommends** that a transitional period of 5 years be provided to allow smaller companies additional time to implement these new provisions.

Annual re-election

Currently, small companies are exempt from having all the directors being subject to annual election by shareholders. Directors of small companies are subject to re-election at intervals of no more than three years. The AIC **recommends** this smaller company exemption is retained.

Subjecting all directors in companies below the FTSE 350 to annual re-election is not appropriate. It risks diverting focus from other, more important, issues, including the need for the board to be comprised of suitable directors and that an appropriate succession plan should be in place.

Requiring all directors to have an annual re-election may also result in short-termism at the expense of the long-term interest of the shareholders and stakeholders.

An annual re-election process will increase the number of shareholder resolutions to be undertaken at the company's AGM. Ensuring proper consideration of resolutions is already a challenge for smaller companies, where proxy agencies and investors may give less attention to their explanations. Annual re-election risks further embedding a tick-box approach to resolutions as it increases the pressure on the governance resources of investors and proxy agencies.

It also raises the question about what would happen if none of the directors were re-elected. Smaller companies may be more likely to have lower investor turnout. They may be more at risk of a few (even a single) large investors determining the outcome of votes for all resolutions. There is more risk of extreme outcomes, such as all directors failing to be re-elected. There is more risk of significant disruption to the company and, ultimately, the shareholders. Companies should be encouraged to balance the benefits of having a regular infusion of new directors with the benefits of having a stable board with sufficient knowledge, experience and history of the company to govern the company effectively.

Were the current position on director re-election retained, shareholders that are unhappy about a certain issue will still be able to make their views clear to the Board. Votes against company resolutions, particularly where they are over 20%, will send a powerful message to the board, and the board will have to respond. This approach creates a strong governance mechanism while also reducing the risk that an adverse vote might fundamentally interrupt the operation of the company.

Externally facilitated board evaluation

Currently smaller companies are exempt from the recommendation to have an externally facilitated evaluation of the board at least every three years. The AIC **recommends** this exemption is retained. Changing the current position will create time and cost burdens for smaller companies without providing any significant benefit to shareholders.

Were the FRC to conclude that smaller companies should be required to have an externally facilitated board evaluation, the AIC **recommends** that this should be required every five years rather than every three years. This is more proportionate for companies outside the FTSE 350. There is nothing to prevent a smaller company having an externally facilitated board evaluation more frequently than the UK Code recommends.

Committee composition

Currently the committee composition provisions state that audit and remuneration committees should be comprised of at least three independent NEDs. For smaller companies, these committees should have at least two independent NEDs. Additionally, for smaller companies, the company chairman may be a member of, but not chair, the audit committee provided he or she was considered independent on appointment as chair. The AIC **recommends** these smaller company provisions are retained.

Many smaller listed companies have smaller boards and so these proposals will have a disproportionate impact on them. Arguably, these proposals will have an even greater impact on investment company boards. Because investment companies often outsource the day-to-day operations of the company, they tend to have smaller boards comprised only of NEDs. These proposals may result in some investment companies having each committee formed of a majority of, or all, board members.

The AIC also **recommends** the new proposal regarding the composition of nomination committees (contained in Provision 17) be amended to reflect the current exemptions for small companies in relation to audit and remuneration committees.

Company boards must be able to exercise independent oversight. Committees of the board report to the full board; which ensures that proper oversight is achieved. There is no reason to tighten the rules for smaller companies. The additional costs and resources required to achieve this would not be offset by any significant benefits to shareholders.

Focus on stakeholder engagement

The proposals place a greater onus on companies to engage, not only with their shareholders, but also with the wider stakeholder community. The AIC recognises that delivering shareholder value has never been divorced from understanding the needs of stakeholders. For example, recognising the needs of employees can improve a business's performance, profit and staff morale.

Most investment companies outsource the day-to-day operations of the company. This means they have boards entirely comprised of NEDs. There are no employees. Instead, the directors appoint third party service providers to carry out the running of the company. The board retains responsibility for oversight and governance of the company.

Apart from its service providers, externally managed investment companies are unlikely to have any significant stakeholders except for their investors. They have no customers, no employees and no appreciable environmental impact.

The UK Code recognises that shareholders have a responsibility to engage with the companies they invest in. As observed above, smaller companies often find it more difficult to engage. This will include situations where investors have employed proxy advisors. All too often proxy agencies take a ‘one size fits all’ approach and try to assess a company’s corporate governance by using a ‘tick box’ approach. This is unhelpful, particularly in the context of the investment companies, given the material differences in the way in which they operate in comparison with conventional ‘trading’ companies.

‘Comply or explain’ provides a mechanism for companies to explain their approach to certain provisions in the UK Code. Different companies should be able to take different approaches to reach the same end goal. Where companies choose to explain how they have applied a principle, it is important that investors, and proxy agencies, evaluate these explanations and form an appropriate judgement.

The AIC **recommends** that proxy voting agencies should be held to appropriate standards and a separate code of best practice (aside from the Stewardship Code) should be developed for proxy advisers to use. Please see our response to question 17 for further detail.

Focus on succession planning and diversity

The AIC recognises the increased focus on diversity and succession planning set out in the proposed UK Code. Achieving the right composition and balance of board members is crucial to a well-functioning board. A wide range of perspectives helps to facilitate broad and robust discussions which will help drive better decision making.

The AIC’s Code recognises the benefits of having a “*balance of skills, experience, length of service and knowledge of the company*”. This ensures boards are properly equipped to face the challenges encountered by any company.

The AIC agrees that merit and the objective consideration of candidates should be the driver of board appointments. Principle J states that both board appointments and succession plans should “*be based on merit and objective criteria, and promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths*”.

This suggests the overwhelming criterion is to assess candidates based on merit. This is particularly important for companies operating in niche markets where finding appropriately skilled board members may be more difficult. It is positive that the new description of diversity includes references to “*cognitive and personal strengths*”.

Possessing “*cognitive and personal strengths*” indicates that individuals will have a strong character and be independently minded. They will be able to provide challenge in board discussions, particularly in relation to topics where they have specific knowledge and skills. They will think independently and will not be reliant on, or simply seek to follow the view of, others.

The proposals also recognise that the environment in which the company operates is likely to change continually. To respond to this, the effectiveness and composition of the board should be regularly evaluated to ensure it continues to meet the needs of the company.

Proposed Principle I states that “*Board membership should be regularly refreshed*”. This is a helpful clarification of the UK Code. It will help ensure boards consider the future needs of the company and adopt an appropriate succession plan.

Response on the UK Code and Guidance on Board Effectiveness

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

The FRC has undertaken “*a comprehensive review*” of the UK Code. Significant changes have been made to the structure of the UK Code. The proposals take account of the FRC’s own Culture Report, the Hampton-Alexander and Parker reviews, and the Government’s response to the Green Paper on Corporate Governance Reform. The review has been wide-ranging.

Sufficient and appropriate time is required for companies to prepare for the new regime. This will be particularly important where companies, particularly smaller entities, may need to adjust their succession plans, for example, in relation to identifying a future chairman, where they wish to comply with best practice. The AIC **recommends** that the proposed application date for the new UK Code is for accounting periods beginning on and after 1 January 2020, rather than 1 January 2019.

The AIC has two further typographical recommendations regarding the section titled ‘Application’ in the UK Code. The AIC **recommends**:

- The reference to the AIC Code be amended to refer to ‘The AIC Code of Corporate Governance’ which aligns with the name of the AIC Code; and
- The reference to the AIC Guide be deleted. In light of the proposed changes to the UK Code, and in association with the FRC, the AIC will consider whether the continued publication of the AIC Guide remains useful. If it is decided that the AIC will continue to publish the AIC Guide, reference to it can be made within the AIC Code.

Q2. Do you have any comments on the revised Guidance on Board Effectiveness?

The AIC has no comments on the revised Guidance.

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

The AIC has no comment on this question.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the UK Code or in the Guidance?

No. Relevant principles, such as the UN’s sustainable development goal on ‘gender equality’ or the goal to ‘promote just, peaceful and inclusive societies’ (which addresses “*building effective, accountable institutions at all levels*”), are already sufficiently incorporated into the principles and spirit of the UK Code and the Guidance.

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?

The AIC considers that 20 per cent is a reasonable level to identify a “significant vote”. If it is included, it will eliminate some of the judgement that is required to interpret the current rule where companies must assess what constitutes a “*significant proportion of votes*”.

Notwithstanding the AIC’s overall support for the proposed threshold, the AIC **recommends** that the FRC qualify this position so that where a vote against a resolution represents less than 5% of the total share capital in issue the specified threshold does not apply. In this situation, a judgement as to whether a “significant proportion of votes” has been cast against would be made by the board.

The AIC **recommends** that this qualification could be applied either to all companies or only those outside the FTSE 350. Qualifying the 20% threshold for smaller companies is consistent with the AIC’s broader view that the governance challenges facing these entities differ from their larger counterparts. It is often difficult for smaller companies to have explanations heard as attention is often focussed elsewhere. This consideration can also contribute to a lower level of voting.

This qualification would help maintain the focus of attention on situations which are most material to achieving good governance. It would reduce the number of situations where low turnout, combined with one or two shareholders opposed to a resolution, results in a disclosure of a significant vote, when this is not a fair reflection of the position. Low turnout is arguably a signal that investors are content with governance arrangements. The AIC expects that, particularly for smaller companies, higher turnout would be seen when there are issues of material concern. Qualifying the 20% threshold would prevent a very small proportion of shareholders inappropriately dominating the debate. It would reduce the risk that their views are erroneously considered to be reflective of a broader strand of shareholder concern.

Not qualifying the 20% threshold may lead to high levels of reporting of purported governance concerns (for example, via the Investment Association register) of smaller companies such as Venture Capital Trusts. These companies have exclusively retail ownership and, as a consequence, very low shareholder voting. A straightforward 20% threshold may lead to significant amounts of reporting that distract from more significant debates over governance practice.

Having a defined threshold, ideally with the AIC’s recommended qualification, does not preclude companies, with votes cast against a resolution of below 20 per cent, from providing further information to their shareholders.

Provision 6 of the revised UK Code says companies should provide a “*summary in the annual report, or in the explanatory notes to resolutions at the next meeting, on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed*”. This will provide further information to shareholders about the specific actions the company took. It will also give shareholders confidence that the Board has listened to shareholder opinion and taken appropriate action.

In cases where disclosure of this information could prejudice the position of the entity, the AIC **recommends** this disclosure need not be provided. This is in line with similar 'Prejudicial disclosure' rules contained in Financial Reporting Standard (FRS) 102. The AIC **recommends** that Provision 6 be amended to explicitly exclude this disclosure in situations where the disclosure might prejudice the interests of the company and its shareholders.

The AIC does not agree that companies should also be required to publish an update to shareholders no later than six months after the vote. This would be in addition to the new provision for companies to provide a summary, where applicable, in the company's annual report. This will introduce an additional regulatory burden for companies without providing a significant benefit to investors. The AIC **recommends** the sentence "*An update should be published no later than six months after the vote.*" be deleted from Provision 6.

The AIC has one further comment to make regarding Provision 7 in Section 1. This states that "*The board should take action to identify and **eliminate** conflicts of interest*" (emphasis added). The AIC **recommends** this is amended to state that boards should "*identify and **manage** conflicts of interest*" (emphasis added). It is inappropriate for the recommendations in the UK Code to be substantially more onerous than the requirements contained in company law. The Companies Act 2006, (section 175) contains provisions for directors to "*avoid*" conflicts of interest.

The AIC **recommends** the UK Code wording follows the wording contained in the Financial Conduct Authority's (FCA) Handbook and the Listing Rules. Both contain provisions for companies to "*manage*" conflicts of interest.

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.

No. The AIC **recommends** an exemption for smaller companies remains.

Please also see our comments in the opening section titled "Creating a proportionate UK Code" for further detail.

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

Please also see our comments in the opening section titled "Delivering independence and appropriate board composition" and our response to question 8 for further detail.

The AIC **recommends** the nine-year period be deleted as an issue relevant to independence. The AIC **recommends** that length of tenure be included in Principle J which addresses diversity.

If this recommendation is not adopted, then the AIC **recommends** that nine years continues to be an indicator of independence, as in the current UK Code. The AIC does not agree that this should be a threshold test which, once crossed, means directors can no longer be independent.

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

Yes. The AIC agrees this is not necessary. The AIC **recommends** no maximum period of tenure should be specified. The UK Code should be sufficiently flexible to meet the needs of different companies. This is achieved by having high-level principles rather than detailed, prescriptive rules.

The AIC **recommends** that Principle J be expanded, as marked up below, to include consideration of tenure:

“Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be in place for board and senior management. Both appointments and succession plans should be based on merit and objective criteria, and promote diversity of gender, social and ethnic backgrounds, tenure, cognitive and personal strengths.”

Companies may also choose to have a policy on tenure, which is disclosed in the annual report. This is also already recommended in the AIC’s Code. This promotes transparency. It also allows users of the accounts to understand how the company approaches succession planning, including issues related to tenure.

Please also see our comments in the opening section titled “Delivering independence and appropriate board composition”.

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

Please see our comments in the opening section titled “Focus on succession planning and diversity”. Below are more detailed comments on the individual provisions in Section 3 of the proposed UK Code.

Provision 17

The AIC **recommends** that exemptions for companies below the FTSE 350 be retained and extended to apply to the new nomination committee provision.

The AIC **recommends** Provision 17 be amended as follows:

“...A majority of members of the committee should be independent non-executive directors, with a minimum membership of three, or, in the case of smaller companies, two”.

If the FTSE 350 exemptions are retained, it will bring the composition recommendations of the nominations committee into line with the audit and remuneration committees.

Please also see our comments in the opening section titled “Creating a proportionate UK Code” for further detail.

Provision 18

The AIC **recommends** the proposal that “*all directors should be subject to annual re-election*” should be amended to retain the current exemption in the UK Code for companies below the FTSE 350.

The current exemption states “*All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to... re-election... at intervals of no more than three years*”.

Please also see our comments in the opening section titled “Creating a proportionate UK Code” for further detail.

Provision 21

Please see our comments in question 6 above.

Provision 23

The AIC **recommends** that bullet point 4 in Provision 23 be deleted. This recommends that the annual report should include “*an explanation on how diversity supports the company in meeting its strategic objectives*”.

Companies are required (under DTR 7.2.8A(R)) to disclose their board diversity policy, the objectives of the diversity policy, how it has been implemented and the results in the reporting period. The proposed new disclosures will add to the length and complexity of the annual report but will not add any real value to investors.

It is not clear how companies will be able to make such a statement without making sweeping generalisations about certain groups of individuals and the perspectives they bring to the board room. This recommendation is likely to result in boiler plate disclosures being made supporting the benefits of diversity.

Diversity brings broader, more generic benefits. It helps to prevent “group think” and helps ensure that a range of perspectives inform board discussions and that decisions are critically assessed. It is difficult, and not always obvious, how this can be linked to specific strategic objectives, for example, to increase turnover or to enter into a new market.

Provision 24

The AIC **recommends** the exemptions for companies below the FTSE 350 in the current UK Code be retained. This will allow the audit committees in smaller companies to continue to have a minimum of two members. It will also allow the chair of the board to be a member of the audit committee provided he or she was considered independent on appointment as chair.

Please also see our comments in the opening section titled “Creating a proportionate UK Code” for further detail.

Provision 32

The AIC **recommends** the exemptions for companies below the FTSE 350 in the current UK Code are retained. This will allow the remuneration committees in smaller companies to continue to have a minimum of two members.

Please also see our comments in the opening section titled “Creating a proportionate UK Code” for further detail.

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.

The AIC has no comment on this question.

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.

The AIC has no comment on this question.

Q12. Do you agree with retaining the requirements included in the current UK Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

There have only been minor changes to Section 4 of the UK Code which addresses audit, risk and internal control. The AIC agrees with the FRC and **recommends** retaining the current requirements.

Please see our comments in question 9 in relation to the membership of the audit committee.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current UK Code? If not, please give reasons.

The AIC supports this approach. Companies are now familiar with the more detailed guidance that was in the UK Code. The restructuring and formatting changes that have been proposed make the revised UK Code easier to read and more accessible.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

Response on the UK Stewardship Code

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?

The AIC supports the Stewardship Code. It helps encourage good stewardship throughout the investment chain.

The current signatory list to the Stewardship Code is divided into three categories: asset managers, asset owners and service providers. The section on service providers includes some proxy advisors.

Investors, both retail and institutional, are increasingly encouraged to engage with the governance of companies they invest in. This has resulted in more asset managers and wealth managers engaging the services of proxy advisers to make voting recommendations on investments they hold. Although proxy advisers play a significant role in corporate governance, they are unregulated and are not required to report against codes of best practice.

In contrast, issuers have substantial obligations under company law, the UK Listing Authority's Listing Rules and the FCA's Disclosure Guidance and Transparency Rules, alongside reporting against the UK Code. Institutional investors have similar obligations. They may also sign up to and report against the UK Stewardship Code which aims to enhance the quality of engagement between investors and companies.

The AIC **recommends** more is done to encourage good governance and stewardship practice by proxy advisers. They should be held to appropriate standards and sign up to codes of best practice, equivalent to those developed by the FRC, to ensure their work is transparent, accurate and reliable.

The AIC supports the provisions in Article 3(j) of the Shareholder Rights Directive. This would require proxy advisers to disclose certain information such as the methodologies they use, the policies and procedures they follow for voting and requiring them to manage conflicts of interest. These are a series of specific disclosures, it does not address the overall governance and stewardship practices of proxy advisers. The AIC **recommends** developing a separate code for proxy advisers. This will assist in addressing these issues by setting specific best practice standards for proxy advisers.

Specifically, the code should recommend proxy advisers:

- Spend sufficient time and devote sufficient resources to understand companies, particularly those with unusual or different market characteristics;
- Engage with issuers on a timely basis, ensuring sufficient time to allow issuers to respond appropriately to any issues raised before reports are circulated to investors;
- Commit, as a matter of best practice, to considering explanations provided by companies when proxy advisers have approached companies and passing these explanations on to clients;
- Appropriately train their staff to ensure they have the expertise required to understand the companies they research and provide voting recommendations on;
- Put in place procedures to prevent and detect factual inaccuracies in reports and amend their reports and voting recommendations where factual inaccuracies are identified;
- Engage with issuers both during and outside of reporting season; and
- Provide issuers with a point of contact to discuss any issues if they arise.

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?

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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?

The AIC has no comment on this question.

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