Financial Reporting Council

Iain Wright Esq MP
Chairman
BEIS Select Committee

26 October 2016

Dear Iain

FRC Response to the BEIS Select Committee Corporate Governance Inquiry

Corporate governance in the UK is highly respected, both domestically and internationally. The strength of capital flows into the UK reflects confidence in the UK's strong governance and proportionate regulation, providing a fundamental underpinning of trust. This includes the UK Corporate Governance Code based on the "comply or explain" principle. In a period of economic uncertainty maintaining that trust and investment is of great importance.

There is, however, widespread public perception and concern that wealth creation is disproportionately favouring a few. A range of factors are causing this. Many employees have seen no pay increase in real terms for years. A significant number have only casual contract conditions and others feel their pensions may be at risk. At the same time it appears that corporate scandals, whatever the cause, go unpunished, that poor executive performance often still earns high rewards and that shareholders benefit from excessive dividends.

Addressing these concerns involves looking at a range of regulatory regimes. Legal protections and enforcement in a number of areas need to be addressed. In addition the UK corporate governance framework – the activities of Government, regulators, directors and investors – will also need to respond.

The Companies Act 2006 places a responsibility on directors to create successful businesses for the benefit of shareholders, taking account of a range of stakeholder and other interests. The pursuit of short-term strategies can prevent these benefits for wider stakeholders from being realised. The intent of the Act therefore needs to be applied more effectively, and new ways of connecting boards to a wider range of stakeholders found. Employees in particular have a demonstrable economic interest in the long-term health of the company, while the country has an interest in how companies invest to raise the capabilities of their people and so enhance competitiveness and growth in a way that benefits the many not the few. The FRC considered many of these issues in its Corporate Culture Report.[1]

[1] https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Repor-(1).pdf

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There are three main principles that should be maintained.

1. The strength of the unitary board, strong shareholder rights and the "comply or explain" approach have long delivered economic success; they should not be compromised. The law holds all directors equally responsible for the decisions of the board. This responsibility now needs to be more closely aligned to the broader set of responsibilities in section 172 of the Companies Act, reported on and effectively monitored.

2. Effective application of the law, both as it stands and where it is changed. The regulatory framework is fragmented and enforcement is not fully effective at present. In the FRC's own area of financial reporting we have powers to sanction accountants, but not directors – who may be just as culpable but happen not to be members of the profession. The gaps need to be closed.

3. Good performance is encouraged and rewarded appropriately. Any changes to the law should take account of this. Shareholder value is driven by external factors as well as by performance. Those who do well deserve reward, while those who perform poorly but benefit from rising markets do not. Boards must retain and use the discretion they have to address such anomalies wisely and take greater responsibility for employee matters across the organisation. They should explain what they have done and why.

The continuing success of our economy depends on the revitalisation and reassessment of our public equity capital markets and of the checks and balances that have characterised the benefits of that market model for so long. We explore how to achieve this in our submission.

Yours sincerely

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Submission by the Financial Reporting Council

Executive summary

1. The UK corporate governance framework is a combination of legislation (chiefly company and financial markets law) and related regulation, codes, guidance and voluntary action which provides a structure of rules, and some flexibility for companies, shareholders and stakeholders to pursue their objectives. The strength of the unitary board, strong shareholder rights and the "comply or explain" approach have long delivered economic success; they should not be compromised.

2. The Financial Reporting Council (FRC) believes that this strong framework promotes good governance and underpins the flow of capital into UK equity markets. However, the continued success of the framework – particularly in times of market uncertainty – depends on achieving an effective balance of responsibilities between the Government and regulators, the application of sound judgement by directors and investors in using the flexibility given to them, and the involvement of a wider range of stakeholders.

3. The Select Committee inquiry is therefore timely and promotes consideration about how the framework should be developed in order to remain an effective means of supporting a strong economy and the needs of wider society. The term "corporate governance" is open to broad interpretation and the FRC supports this. Nevertheless, it should be borne in mind that many other areas of law and regulation affect the way in which a range of corporate forms operate and behave – employment, tax, pensions, competition and consumer law for example – which the Committee should take account of as part of its inquiry.

4. Examples of poor corporate conduct have damaging consequences for companies, the economy and society as a whole, and in many instances demonstrate that the views and needs of wider stakeholders have not been given appropriate consideration. Such cases erode trust between society and business. There is a need for improvement in the way in which the law, regulation and codes operate and are enforced and this submission makes recommendations in this area – within and outside of the FRC's current operations and powers.

FRC recommendations

- *There is scope to improve the way in which s172 operates. This could be achieved through more focused reporting on the elements of s172 to which directors should have regard in order to focus boards on their responsibilities in this area and how they have satisfied themselves on the effectiveness of risk management and controls. Such disclosure should be supplemented by reporting about related issues which are of key importance to shareholders and wider stakeholders, such as how the company allocates funds between pensions, dividends, directors' remuneration, investment and capital investment. This could be achieved through additional principles and provisions in the UK Corporate Governance Code which provide for disclosure in companies' annual reports and related changes to the FRC's Strategic Report Guidance.*
- *Consideration should be given to a possible future review of the UK Corporate Governance Code and the associated guidance to develop best practice and provide further guidance for boards about how to deliver their responsibilities to a range of stakeholders. There is also scope to revise the UK Corporate Governance Code to explore how to take account of the views of wider stakeholders either through assigning*

responsibility to a non-executive director or creating other methods of stakeholder engagement such as stakeholder advisory committees.

- *A future review of the UK Corporate Governance Code should examine whether the disclosures relating to board communication should be strengthened in order that shareholders and wider stakeholders might scrutinise them and challenge more effectively where necessary.*
- *A code or guidance directly applicable to the governance arrangements of large private companies should be developed. The FRC is prepared to lead this.*
- *The FRC is currently assessing the way in which it monitors the quality of UK Corporate Governance Code reporting, including the option of more direct contact with companies where explanations are not adequate, and publicising good and poor practice.*
- *We recommend the Government reviews the enforcement framework in order to establish an effective mechanism for holding directors and others in senior positions to account when they fail in their responsibilities.*
- *A future review of the UK Corporate Governance Code should consider the role of the remuneration committee in having responsibility for a wider remit including the pay and conditions of the company workforce and reporting on the link between remuneration structure and strategy. The role of the committee in exercising discretion in relation to awards and the terms in which it would do so should also be strengthened.*
- *The Government should consider a wide-ranging inquiry into the issues raised by the quantum, growth, disparity and performance-linkage of rewards received by senior executives in a range of corporate forms.*
- *A future review of the UK Corporate Governance Code should explore whether and how, when there are significant shareholder votes against a remuneration report (for example, 20 per cent or more) companies should respond through additional shareholder consultation and reporting. Such a mechanism might be strengthened for more significant votes against which fell short of the 50 per cent majority required.*
- *The FRC supports the work and aims of the Hampton/Alexander and Sir John Parker reviews and in a future review of the UK Corporate Governance Code and associated guidance will consult on recommendations proposed by these reviews in order to improve board diversity, including reporting on actions and progress.*

FRC responsibilities

5. The FRC's mission is to promote high quality corporate governance and reporting to foster investment. We undertake a number of Government delegated and voluntary functions and responsibilities, all of which contribute to the effective functioning of the capital markets. We help ensure that investors can allocate their capital with reasonable confidence that companies are properly assessing risks. In turn, the entities in receipt of that investment can have the confidence to invest in their own strategies and workforces.

6. We also promote trustworthy behaviour and information through:
   - setting UK standards for accounting, audit and actuarial work;
   - providing guidance on narrative reporting, contributing to high quality international standards, and through the work of the Financial Reporting Lab;
   - monitoring the quality of accounts published by public companies in line with the legal framework including accounting standards and the overriding requirement to

give a true and fair view; making clear our expectations of how companies and other entities should approach financial reporting and regularly highlighting the matters we regard as particularly important;

- monitoring and reporting publicly on the quality of the audits of listed and other major public interest entities, setting the policies and procedures to support audit quality at the major audit firms in the UK and determining proportionate sanctions, where necessary; and highlighting key messages on audit quality for audit firms and audit committees; and
- oversight of the regulatory activities of the accountancy and actuarial professional bodies and through our own enforcement arrangements, as well as by co-operating with other bodies – such as the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Pensions Regulator (TPR) – and the professionalism of their work. Please also see our recommendation in relation to Question 8.

7. We are also responsible for promoting high standards of behaviour by boards and investors by setting the UK Corporate Governance and Stewardship Codes. The UK Corporate Governance Code, which applies to Premium Listed companies, is monitored by investors and based on the underlying principles of good governance: accountability, transparency, probity and a focus on the sustainable success of an entity over the longer-term. It includes a clear principle that boards should provide annual reports and other information that is trustworthy and so present a fair, balanced and understandable assessment of the company's position and prospects. The UK Corporate Governance Code has enabled significant changes in behaviours and reporting to be achieved rapidly and effectively in a way that legislation cannot. The UK Stewardship Code sets out the principles of effective stewardship by investors to build confidence in the system and give force to the "comply or explain" system on which the UK Corporate Governance Code is based, as well as increasing accountability to clients and beneficiaries.

8. Legislation, regulatory sanctions and codes influence people's behaviour but do not ultimately control it. The FRC has been investigating the purpose of business and its relationship with society through its Corporate Culture Report.[2] Culture in a corporate context is a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders. These stakeholders include shareholders, employees, customers, suppliers and the wider community and the environment, all of which are affected by a company's conduct. The report sets out observations and practical considerations and there is clearly more to be done to promote better corporate cultures and more trust in business.

<u>Directors Duties</u>

<u>Q1. Is company law sufficiently clear on the roles of directors and non-executive directors, and are those duties the right ones? If not, how should it be amended?</u>

9. The UK Companies Act 2006 (CA06) clearly sets out a wide range of director's duties in sections 170-177. The FRC does not see a need to add to these. The Act does not define or distinguish between the roles of executive and non-executive directors. The UK's unitary board system is designed to deliver clear collective leadership and responsibility. To distinguish – in law – between the roles and responsibilities of

[2] https://frc.org.uk/Our-Work/Publications/Corporate-Governance/Corporate-Culture-and-the-Role-of-Boards-Repor-(1).pdf

executive and non-executive directors would hinder the operation of the unitary board, obstruct effective decision-making, reduce the flexibility to create governance arrangements suitable to the specific circumstances of a company and ultimately dilute standards of governance.

Q2. Is the duty to promote the long-term success of the company clear and enforceable?

10. Section 172 (a-f) CA06 sets out to whom and what directors should "have regard to" in promoting the success of the company for the benefit of its members as whole. The "likely consequences of any decision in the long-term" is one of these factors.[3]

11. Under UK company law it is shareholders who hold boards to account in how they discharge their duties. This provides legal certainty and clarity. Enabling other stakeholders – directly through company law – to enforce a wide range of duties brings with it two major risks:
    - A weakening of public equity markets as shareholders withhold or restrict investment where they perceive that they will not have effective control of their assets; and
    - The competing interests of stakeholders lead to expensive and distracting legal disputes.

12. Section 172 is effectively enforceable only by shareholders. The FRC's view is that there is a need to explore mechanisms which will enable this section to deliver its purpose more effectively. Current corporate responsibility and sustainability reporting does not deal adequately with these matters. There is a lack of information about how the matters referred to are taken into account by directors in promoting the success of the company. There is also insufficient communication about the implementation of company strategy on apportioning funds to other important matters such as tax, dividends, directors' remuneration and capital allocation.

13. Recommendation – There is scope to improve the way in which s172 operates. This could be achieved through more focused reporting on the elements of s172 to which directors should have regard in order to focus boards on their responsibilities in this area and how they have satisfied themselves on the effectiveness of risk management and controls. Such disclosure should be supplemented by reporting about related issues which are of key importance to shareholders and wider stakeholders, such as how the company allocates funds between pensions, dividends, directors' remuneration, investment and capital investment. This could be achieved through additional principles and provisions in the UK Corporate Governance Code which provide for disclosure in companies' annual reports and related changes to the FRC's Strategic Report Guidance.

Q3. How are the interests of shareholders, current and former employees best balanced?

14. Balancing the interests of all stakeholders is important. CA06 makes it clear directors should take account of the interests of employees – amongst others – in promoting the success of the company. Inevitably the interests of different stakeholders will not always

[3] This is supported by the Code, which was amended in 2014 to strengthen the focus of companies and investors on the longer-term and the sustainability of value creation by the requirement of inclusion of a 'viability statement' in companies' annual reports. This should provide a full and clear assessment of principal risks and an improved and broader assessment of long-term solvency and liquidity over periods significantly longer than 12 months. We are currently assessing the effect of the first year of full reporting and will report the results in our next annual "Developments in Corporate Governance and Stewardship" report to be published in January 2017.

be the same. However, where there is broad alignment in their objectives, a focus on how business is conducted and how stakeholders are treated will create opportunities for value creation which have benefits for all.

15. The UK Corporate Governance Code gives boards a responsibility for setting the company's values and standards (Supporting Principle A1) while the preface gives boards a role in establishing the culture, values and ethics of the company.

16. The FRC's Corporate Culture Report found that a clearly defined purpose which goes beyond profit, and well-chosen values that are translated into a set of expected behaviours embedded throughout the company, are essential for a healthy culture and can motivate and build trust with employees. Ultimately it is the responsibility of the board to achieve this and effective succession planning should take this into account.

17. Recommendation – Consideration should be given to a possible future review of the UK Corporate Governance Code and the associated guidance to develop best practice and provide further guidance for boards about how to deliver their responsibilities to a range of stakeholders. There is also scope to revise the UK Corporate Governance Code to explore how to take account of the views of wider stakeholders either through assigning responsibility to a non-executive director or creating other methods of stakeholder engagement such as stakeholder advisory committees – please also see our answer to Question 16.

<u>Q4. How best should the decisions of boards be scrutinised and open to challenge?</u>

18. Currently board decisions are reported through Regulatory News Service announcements and the annual report and accounts. Shareholders express their opinions on these decisions through ongoing engagement with companies and by exercising extensive voting and other rights. This engagement is encouraged by the UK Stewardship Code.

19. The UK Corporate Governance Code Principles and provisions relating to board accountability and disclosure are:

    Provision A.1.1
    The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.

    Supporting Principle A.3
    The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.

20. There are also provisions for disclosures relating to board effectiveness (Section B) financial and business reporting (Section C) and relations with shareholders (Section E).

21. Recommendation – A future review of the UK Corporate Governance Code should examine whether the disclosures relating to board communication should be strengthened in order that shareholders and wider stakeholders might scrutinise them and challenge more effectively where necessary.

Q5. Should there be greater alignment between the rules governing public and private companies? What would be the consequences of this?

22. Generally speaking, public companies are subject to greater regulation and scrutiny than private companies due to their access to traded public equity markets and their greater separation of ownership and control. This is necessary for the public interest and for the protection of shareholders.

23. In private companies ownership and control are often vested in the same individuals or entities. For many such companies, the costs of subjecting them to greater regulation and scrutiny have been generally deemed to outweigh the benefits. However, there are many large private companies which are economically significant and there are strong arguments to suggest that they should be more transparent about their governance. This is, therefore, not so much a question of alignment, but of a tailored code or guidance or regulated disclosure which takes into account the specific circumstances of large private companies, which are not uniform in their ownership arrangements. A “large private company” should be proportionately defined by a suitable significant minimum threshold of turnover and/or number of employees.

24. Recommendation – A code or guidance directly applicable to the governance arrangements of large private companies should be developed. The FRC is prepared to lead this.

Q6. Should additional duties be placed on companies to promote greater transparency, e.g. around the roles of advisors. If so, what should be published and why? What would the impact of this be on business behaviour and costs to business?

25. Please see the recommendation in Question 2. There are already disclosure requirements in respect of auditors and remuneration consultants, but inevitably there will be issues of commercial confidentiality around the wide range of advice which a company receives. Where the advice acted upon leads to decisions which require disclosure to shareholders of information which is material to the development, performance, position, or future prospects of the company disclosure is already made, but could be improved.

Q7. How effectively have the provisions of the 1992 Cadbury report been embedded? How best can shareholders have confidence that executives are subject to independent challenge?

26. The recommendations of the 1992 Cadbury Report have been effectively embedded in listed companies. Since 2003 the FRC has been responsible for the UK Corporate Governance Code and has revised and updated it regularly in order to lead market practice. Throughout all of these changes, the “comply or explain” approach first set out in the Cadbury Report has been retained and proved robust: it allows for flexibility. Imposing a rigid set of rules would not take account of a companies’ particular circumstances – size, sector, stage of development etc. – and would lead to unsuitable and lower quality governance arrangements.

27. It is for shareholders to monitor corporate governance reporting – in particular where companies depart from the UK Corporate Governance Code provisions – and satisfy themselves that governance arrangements are effective. Where shareholders consider that this is not the case, they should engage with companies to effect the changes they believe are required.

28. Constructive engagement between companies and investors is crucial to the health of the UK's corporate governance framework. In 2010 the FRC also took responsibility for the UK Stewardship Code, under which institutional investors report on their policies for monitoring and engaging with the companies in which they invest. This year we have undertaken a full assessment of the quality of reporting by the 300 signatories to the UK Stewardship Code and will publish the results in early November 2016. This will include tiering the quality of statements made by asset managers, owners and other service provider signatories.

29. The FRC monitors reporting against both Codes. In 2016 90 per cent of FTSE 350 companies complied with all but one or two of the UK Corporate Governance Code's 54 provisions. Despite a gradual improvement in the quality of explanations where companies decide to depart from UK Corporate Governance Code provisions, the FRC believes that better quality explanations can be achieved and is now considering further action to achieve this. Without changing the law or Listing Rules, this would be on a voluntary basis.

30. Recommendation – The FRC is currently assessing the way in which it monitors the quality of UK Corporate Governance Code reporting, including the option of more direct contact with companies where explanations are not adequate, and publicising good and poor practice.

<u>Q8. Should Government regulate or rely on guidance and professional bodies to ensure that Directors fulfil their duties effectively?</u>

31. The key, though not only relationship is between the company and its shareholders, rather than the company and the Government or a regulator. The UK's corporate governance framework promotes the role of directors and shareholders to scrutinise and ensure that their companies are being led and managed to achieve success. Nevertheless, there is a need to encourage transparency and accountability to a wider range of stakeholders in order to promote sustainable growth and help UK businesses to regain public trust.

32. While guidance and the role of professional bodies plays an important part in holding directors to account there exists a complex regulatory framework under which a wide range of corporate investigations take place (a table explaining the FRC's and others' responsibilities is at Annex A). This has the capacity to delay and dilute effective enforcement against misconduct.

33. Recommendation – We recommend the Government reviews the enforcement framework in order to establish an effective mechanism for holding directors and others in senior positions to account when they fail in their responsibilities.

<u>Executive pay</u>

<u>Q9. What factors have influenced the steep rise in executive pay over the past 30 years relative to salaries of more junior employees?</u>

34. There is no single explanation for the increase in executive pay. At the FTSE 100 level, one factor is the perception that to attract quality executives and compete globally remuneration must be comparable to or greater than that offered elsewhere. Others contend that there is sufficient quality and diversity of talent which is currently being overlooked for a variety of reasons.

35. Another issue is the complexity of remuneration packages, particularly of share-based performance metrics which may lead to difficulty setting effective targets, or a push for more generous possible outcomes given the uncertainty of the award.

36. Greater transparency of pay awards is often cited as having had a 'ratchet' effect, however remuneration in some areas which do not require public disclosure also appear to have grown significantly.

Q10. How should executive pay take account of companies' long-term performance?

37. Remuneration should focus on aligning reward with the sustained creation of value rather than on "recruiting, retaining and motivating" – a focus that has tended to promote pay escalation. The UK Corporate Governance Code was amended in 2014 to reinforce the importance of this longer-term view.

38. There is a need for greater emphasis to be placed on ensuring that remuneration policies are designed with reference to the long-term success of the company. The lead responsibility for doing so rests with remuneration committees.

Q11. Should executive pay reflect the value added by executives to companies relative to more junior employees? If so, how?

39. Boards and remuneration committees should ensure they are paying significant attention to the nature and structure of incentives and the behaviour they drive. Boards should then explain to investors and employees how they have made this assessment and properly aligned the remuneration structures. Remuneration and risk committees are in a position to support boards in evaluating alignment between incentives, values and behaviours.

40. Recommendation – A future review of the UK Corporate Governance Code should consider the role of the remuneration committee in having responsibility for a wider remit including the pay and conditions of the company workforce and reporting on the link between remuneration structure and strategy. The role of the committee in exercising discretion in relation to awards and the terms in which it would do so should also be strengthened.

Q12. What evidence is there that executive pay is too high? How, if at all, should Government seek to influence or control executive pay?

41. There is a gap between the level of remuneration offered to executives and the views and expectations of the public. The inconsistent alignment between executive remuneration and company performance and between the remuneration of senior executives and employees has led to a lack of public confidence. This has taken place despite efforts to improve transparency and accountability. There is widespread concern that these remuneration structures and the accompanying regulations are defective to the extent that a comprehensive review of the situation – which should not be restricted only to public companies, but private companies and other corporate forms too – can resolve it.

42. Recommendation – The Government should consider a wide-ranging inquiry into the issues raised by the quantum, growth, disparity and performance-linkage of rewards received by senior executives in a range of corporate forms.

Q13. Do recent high-profile shareholder actions demonstrate that the current framework for controlling executive pay is bedding in effectively? Should shareholders have a greater role?

43. The binding vote on remuneration policy is relatively new, with around 50 per cent of FTSE 350 companies putting their remuneration policy forward for the binding shareholder vote for the second time in 2017. The effect of this legislation should be considered by the Government after the 2017 annual general meeting season.

44. Some companies report a lack of engagement on the part of investors, noting that it can be difficult to gather collective views. Some investors have acknowledged this concern and are moving to engage through groups such as the Investor Forum, which has a wide remit focusing on long-term strategy and performance. However, there is no single view of what is most effective or appropriate in relation to remuneration incentives and structures.

45. There is always capacity to encourage greater engagement between shareholders and companies. The Government is considering whether to make a majority shareholder vote on the remuneration report have mandatory – rather than the current advisory – effect. There is also scope to consider whether, in cases where votes against the report have reached a significant threshold, it would be possible to recommend greater shareholder consultation and reporting through the UK Corporate Governance Code.

46. Recommendation – A future review of the UK Corporate Governance Code should explore whether and how, when there are significant shareholder votes against a remuneration report (for example, 20 per cent or more) companies should respond through additional shareholder consultation and reporting. Such a mechanism might be strengthened for more significant votes against which fell short of the 50 per cent majority required.

Composition of Boards

Q14. What evidence is there that more diverse company boards perform better?

47. The major benefit of diversity is improving long-term business performance by avoiding "groupthink" – when conformity in the group can result in poor decision-making and outcomes. The benefits of a more diverse board include:
    - diversity of thought and approach which ensure appropriate challenge in boardroom discussions;
    - supporting engagement with a wider range of stakeholders; and
    - keeping boards in touch with public and customer views on particular issues.

48. It is accepted that there are issues surrounding search, selection and the pipeline and that there is a need to broaden the talent pool. However, many respondents to the FRC's discussion paper on succession planning published in October 2015[4] highlighted that the very fact that individuals do not fill "conventional" criteria is likely, of itself, to bring valuable additional perspectives and strengthen board decision-making. In the FRC's Feedback Statement on succession planning[5] a clear view was expressed that boards as a whole should be better informed about the link between diversity, strategy and business value.

[4] https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Discussion-Paper-UK-Board-Succession-Planning-(1).aspx
[5] https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Feedback-Statement-Succession-Planning-Discussion.pdf

Q15. How should greater diversity of board membership be achieved? What should diversity include, e.g. gender, ethnicity, age, sexuality, disability, experience, socio-economic background?

49. The update to the preface of the UK Corporate Governance Code in 2014 widened the definition of what the FRC would expect diversity to cover in terms of the board:

    "Essential to the effective functioning of any board is dialogue which is both constructive and challenging. The problems arising from "groupthink" have been exposed in particular as a result of the financial crisis. One of the ways in which constructive debate can be encouraged is through having sufficient diversity on the board. This includes, but is not limited to, gender and race. Diverse board composition in these respects is not on its own a guarantee. Diversity is as much about differences of approach and experience, and it is very important in ensuring effective engagement with key stakeholders and in order to deliver the business strategy."

50. In the responses to the FRC's discussion paper on succession planning, some guarded against "diversity for the sake of diversity" and that boards must be clear about the particular skills needed and assess these objectively. It should not be a "tick-box" exercise.

51. The FRC supports the work of Sir John Parker's review of ethnic diversity in the boardroom and is positively engaging with it. Please see the recommendation in relation to Question 17.

Q16. Should there be worker representation on boards and/or remuneration committees? If so, what form should this take?

52. Our discussions with companies, investors and other stakeholders demonstrate that a wide variety of methods are already successfully used to engage with employees, customers and a broad range of parties with an interest in the way in which a company is run. These discussions also clearly show that further progress is needed, and that this should be not be limited to particular groups, but achieved through developing and expanding the ways in which engagement can take place.

53. The FRC believes further proposals in this area should not restrict the methods of consultation. Appointments to the board are one way but should not unnecessarily promote one group over another. A flexible approach can be achieved through revising the UK Corporate Governance Code and associated guidance – please see the recommendation in relation to Question 3.

Q17. What more should be done to increase the number of women in executive positions on boards?

54. The FRC supports the Hampton/Alexander review which was announced in July 2016 and is due to publish its first report in November 2016. The review aims to improve female representation in leadership positions of British business, broadening the ambition to the entire FTSE 350 and raising the target to 33% of women on boards by 2020. The focus for the work on the pipeline will be on representation on executive committees and direct reports to the executive committee in FTSE 350 companies. The review is aimed at removing barriers so that talented women are able to succeed in achieving executive and director positions. Prior to this, Lord Davies's work resulted in the numbers of females on FTSE 100 boards rising from 12.5% to 26% from 2010 to

2015. The UK Corporate Governance Code was revised in 2010 and 2012 as part of this review and diversity reporting has improved as a result.

55. Recommendation – The FRC supports the work and aims of the Hampton/Alexander and Sir John Parker reviews and in a future review of the UK Corporate Governance Code and associated guidance will consult on recommendations proposed by these reviews in order to improve board diversity, including reporting on actions and progress.

Annex A

	Criminal proceedings	Civil proceedings	Professional regulatory / enforcement proceedings
Company Directors	Liable to criminal proceedings for matters arising from their performance of their professional responsibilities including specific failures set out in companies legislation. Matters to be proved will depend on the criminal offence. Standard of proof is the criminal standard of proof.	In the main, individual directors are not liable to civil action – rather the Company will be liable. However, there are exceptions including shareholder actions for breaches of the duties of a director. The standard of proof is the civil standard of proof. The Company Directors Disqualification Act 1986 (CDDA) provide for the disqualification of company directors in civil proceedings where one or more of the following have been proven (to the civil standard of proof): • Unfit conduct in the promotion, formation, management or liquidation of a company • Wrongful trading (such as trading while insolvent) • Failure to comply with filing requirements under the Companies Act legislation • Breaches of competition law • Following conviction for criminal offences (either in the UK or abroad) related to the promotion, formation, management or liquidation of a company. Any breach of a disqualification order is a criminal offence. CDDA proceedings will usually follow insolvency proceedings and the Insolvency Service is the delegate of the Secretary of State (SoS) for the purposes of the Act.	Company directors are not regulated in the same way as the professions. So there is no system of regulation which applies to all company directors. By the FRC – the FRC is authorised by the SoS to apply to court for an order requiring the directors of a company to prepare revised report and accounts where the annual report and accounts did not comply with the requirements of the Companies Act 2006. If the court grants the order sought then it can also order that the directors pay the costs of the litigation. While this is a civil procedure, its origin is in a regulatory enforcement activity. By the accountancy/actuarial bodies and the FRC – where the director is a member of an accountancy body or the Institute and Faculty of Actuaries (IFoA), the disciplinary processes detailed below will also apply. By other professional bodies – where the director is subject to the regime of another regulator e.g. the *Solicitors Regulation Authority* (SRA), in certain circumstances, they may also take action. By the FCA – authorised persons who are also directors will be liable to FCA proceedings for e.g. breaches of FSMA and the FCA Handbook. Possible sanctions include disqualification (as an authorised person) and financial penalties.

Annex A

	Criminal proceedings	Civil proceedings	Professional regulatory / enforcement proceedings
Auditors	As above	Liable to civil proceedings for breach of contract or for negligence where there has been a breach of the duty of care owed to an individual or group of individuals and where that breach has caused damage/loss. Also liable to civil proceedings for specific statutory failures. Standard of proof is the civil standard of proof.	Auditors of PIEs – Members and member firms (of recognised supervisory bodies (RSBs)) liable to enforcement proceedings by the Competent Authority for Audit (the FRC) under its Audit Enforcement Procedure. Matter to be proved is a breach of the audit requirements which include regulatory requirements, EU Audit Regulation requirements and technical and ethical standards. The standard of proof is the civil standard of proof. The range of sanctions is prescribed in statute and includes withdrawal of the licence to audit, conditions on the licence, financial penalties. Auditors of non-PIEs – Members and member firms liable to disciplinary proceedings by their RSB. Each RSB has different rules but in essence, issues identified through complaints or through audit quality monitoring are dealt with under their disciplinary or audit registration bye laws. Matters to be proved will vary depending on the complaint but include: Under the disciplinary bye-laws • an act or default or incompetence likely to bring discredit on himself, the RSB or the profession; • a breach of the RSBs bye-laws or of any regulations or any failure to comply with any order of an RSB committee; Under the RSBs audit rules • that the continued registration of the firm may adversely affect an audit client or any other person; or • the firm has not complied with any notice issued by the Competent Authority and, in the circumstances, withdrawal is justified. In either case the standard of proof is the civil standard of proof. Auditors of PRA-authorised persons or FCA firms are also subject to the disciplinary regimes maintained by the PRA and FRC respectively within the frameworks set out in FSMA.

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	Criminal proceedings	Civil proceedings	Professional regulatory / enforcement proceedings
Accountants	As above	As above	Accountancy body members and member firms liable to disciplinary proceedings by their chartered body. Matter to be proved will depend on the subject matter of the complaint but include: • an act or default or incompetence likely to bring discredit on himself, the accountancy body or the profession; • a breach of the accountancy body bye-laws or of any regulations or any failure to comply with any order of an accountancy body committee. Members also liable to proceedings under the FRC's Accountancy Scheme where the matter raises important issues affecting the public interest. In either case the standard of proof is the civil standard of proof. There is no monitoring of accountancy work in the same way as the quality of audit work is monitored and so there is no equivalent for accountants of the audit registration procedure.
Actuaries	As above	As above	Members of the IFoA (actuarial professional body) are liable to disciplinary proceedings. The matter to be proved is misconduct i.e.: • any failure to comply with the standards of behaviour, integrity, competence or professional judgement which other Members or the public might reasonably expect of a Member having regard to the Bye-laws of the IFoA and/or to any code, standards, advice, guidance, memorandum or statement on professional conduct, practice or duties issued by the IFoA or the FRC. Members also liable to proceedings under the FRC's Actuarial Scheme where the matter raises important issues affecting the public interest. In either case the standard of proof is the civil standard of proof.

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	Criminal proceedings	Civil proceedings	Professional regulatory / enforcement proceedings
			Firms are not members of the IFoA – only individuals are liable to the procedures above. And there is no monitoring of the quality of actuarial work. Depending on the scope of their work actuaries may also be subject to the regulation of the Pensions Regulator. Actuaries appointed by PRA-authorised persons or FCA firms are also subject to the disciplinary regimes maintained by the PRA and FRC respectively within the frameworks set out in FSMA.