

Ms Catherine Horton
Financial Reporting Council
8th Floor, 125 London Wall
London
EC2Y 5AS
Email codereview@frc.org.uk

25th February 2018

Dear Ms Horton,

UK Corporate Governance Code and Guidance on Board Effectiveness: Comments and Response to Questions

GGS welcomes the opportunity to respond to the UK Corporate Governance Code and Guidance on Board Effectiveness, and to the UK Stewardship Code Consultation Questions.

Global Governance Services Ltd. (GGS) provides corporate governance services in governance standards, board evaluation, training and development and writing articles, books and toolkits. Its clients include governments, regulators, companies, universities, professional bodies and financial institutions worldwide.

Overall comments

GGS fully supports the FRC's endeavour to keep the Code as a principles-based document. We also support the removal of supporting principles from the current code and note that in some instances the content of these supporting principles has been inserted into the "Guidance on Board Effectiveness".

"Differentiating very clearly between what is a principle and what is a practice can actually help us be rid of the mindset of box ticking in corporate governance."

Ansie Ramalho, Convenor of King 4 Report ¹

However, we find it very surprising that the FRC has remained with the "comply or explain" approach (p.1) and has apparently not even considered more recently developed approaches of "apply or explain" (e.g. Tabakasblat Dutch Code of Corporate Governance, 2003) or "apply and explain" (King 4 Corporate Governance Report of Southern Africa 2016 and the Mauritian National Corporate Governance Code 2016).

¹ Ramalho quoted in From companies to Markets: Global Development in Corporate Governance IFC (2016) p.72.

Exponents of these newer frameworks argue that these approaches provide:

- Organisations with a clearer understanding of and distinction between mandatory regulation and non-binding recommendations of good practices.
- A clear responsibility of the board to discuss the *application* of each of the principles and to report on these deliberations.
- A movement away from box ticking mindsets.
- A wider group of companies that the code can be applied to (e.g. large non-listed companies).
- The flexibility for organisations to adopt processes and procedures that suit its individual circumstances. This approach recognises that “one size does not fit all”.

Over the last year, both South Africa and Mauritius have very successfully introduced “apply and explain” approaches into their national codes.

We recommend that the FRC consider the introduction of an “apply and explain” approach involving the new Principles.

GGs also fully supports the emphasis within the Code being given to organisational culture and board behaviours and we welcome the focus on governance moving from “tick box” compliance to processes, outputs and outcomes that will deliver sustainable businesses.

Application of the Code

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

No.

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

GGs fully supports the format of Revised Guidance on Board Effectiveness. We believe that the Board should focus on the annual report’s explanation of how an entity has *applied* the principles contained within the Code. The Guidance should prompt the content of the annual report to cover responses to the following questions:

- Have all the key areas of corporate governance been included in the annual report and / or on the website?
- Are the organisation’s corporate governance activities consistent with the principles contained within the Code?
- Are the organisation’s corporate governance activities contributing to the delivery of business objectives and adding value?

Where material deviation from any guidance occurs, however, the annual report should provide an explanation. The organisation’s explanations may be affected by specific circumstances and, in particular, by the size, sector and complexity of the organisation and the nature of the risks and challenges it faces. Whilst shareholders and regulators have every right to challenge an organisation’s explanations if they are unconvincing, such explanations should not be evaluated in a mechanistic and box-ticking way, and departures from the guidance should not automatically be treated as breaches.

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

The proposed methods in Provision 3 are considered to be sufficient to achieve meaningful engagement. GGS strongly agrees that the board should have a responsibility for considering the needs and views of a wide range of stakeholders. The principal duty of all directors, however, remains to the company. This is often described as an “*enlightened shareholder approach*”. This concept may require further clarification and emphasis in the Code since many commentators confuse this with the “stakeholder approach” which involves rights, duties, accountabilities and liabilities towards all stakeholders. This issue involving the balancing of stakeholders’ rights is currently being debated by policy makers in both South Africa and India.

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

Yes, GGS recommends that the FRC should refer to specific frameworks within the Guidance and not the Code.

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?

Yes, GGS agrees with the 20% threshold as being reasonable.

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?

GGS agrees and welcomes this change since we believe that board evaluation is a major source of board renewal. We strongly recommend that this recommendation should be implemented by all companies covered by the code.

However, we find it very inappropriate that the proposed revisions suggest that an externally facilitated board evaluation carried out by a non-independent evaluator should still be permitted. The proposed revisions allow for “a statement ... as to whether they [the evaluator] have any other connection with the company or individual directors.” In our view, having extensive experience in this field, conflicts at this level simply should NEVER be allowed. A lack of independence by an evaluator cannot be addressed by merely stating the nature of other connections.

In addition, the FRC should perhaps consider the need for developing professional standards for independent directors. GGS believes that the definition of the independence of an external board evaluator is lacking and requires detailed clarification. In particular, non-pecuniary relationships between the independent evaluator and the chairman of the board requires very careful consideration.

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

GGS agrees with the nine-year period as being a reasonable time period in the Guidance. This is becoming established as the norm throughout the World. In some cases, some countries are using an even shorter period e.g. Bank of Mauritius (the Mauritian Central Bank) uses a 6 year period.

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

No.

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

Yes.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350?

Yes.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines?

The Guidance should encourage companies to report on this.

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

Yes.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code?

Yes

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?

GGs agrees that the remuneration committee should have a wider remit particularly taking on responsibility for oversight of company remuneration and wider workforce policies.

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

No comment

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

Yes, the Guidance should encourage boards to focus upon long-term sustainable performance and exercise appropriate discretion.

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?

GGs believes that the Stewardship Code should be applicable to all parts of the chain and be based upon Principles.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional ‘comply or explain’ format?

We strongly recommend that the FRC consider an “apply and explain” approach (see pages 1 and 2 in the overall comments).

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?

No comment

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

No comment

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

No comment

Q22. Would it be appropriate to incorporate ‘wider stakeholders’ into the areas of suggested focus for monitoring and engagement by investors?

Yes

Should the Stewardship Code more explicitly refer to ESG factors and broader social impact?

Yes

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out?

No comment.

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

No comment.

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

No comment

Q26. What role should independent assurance play in revisions to the Stewardship Code?

No comment

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

No comment

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

Yes.

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

Yes.

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?

Yes

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?

Yes.

Please do not hesitate to contact me should you wish to discuss any aspects raised in this letter.

Yours sincerely

Dr. Chris Pierce
CEO.
Global Governance Services Limited.