

Mercer response to FRC Corporate Governance Code Consultation

16 February 2018

Question
<i>UK Corporate Governance Code and Guidance on Board Effectiveness Questions</i>
<p>1. Do you have any concerns in relation to the proposed Code application date?</p> <p>Mercer considers that the timing is sufficient. It is important timing does not slip so that companies have time to prepare.</p>
<p>2. Do you have any comments on the revised Guidance?</p> <p>Mercer has no specific comments on this proposal.</p>
<p>3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?</p> <p>Mercer is supportive of these proposals which enable companies to choose the approach which best suits their market sector, size, geographical dispersion and culture. Mainland Europe companies may already operate a workforce advisory council. Mercer notes that obtaining workforce views and having a representative may be more difficult in organisations without an employee body or a trade union, which would add to cost. The other approaches will also incur costs.</p>
<p>4. 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?</p> <p>Mercer has no specific comments on this proposal.</p>
<p>5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?</p> <p>Mercer notes that winning at least 80% shareholder support is a high standard - it is higher than the 75% standard required to pass a special resolution in Company Law. Votes against a remuneration report may sometimes reflect nothing more than different but strongly-held views about the best performance measures, time horizons, incentive vehicles for the company at a given time, and it would be a backward step if the 20% rule discouraged innovation. One only has to look at the range of views on LTIPs to realise that one size does not fit all. Mercer supports the proposed process for highlighting shareholder concerns, but there should be no shame or sanction for implementing good decisions on remuneration supported by say 60% or more of the votes.</p>
<p>6. 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 some information relating to the potential costs and other burdens involved.</p> <p>Mercer has no specific comments on this proposal.</p>
<p>7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?</p> <p>Mercer supports this proposal.</p>
<p>8. Do you agree that it is not necessary to provide for a maximum period of tenure?</p> <p>Mercer agrees with this proposal.</p>

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

Mercer supports this. Many FTSE 100 companies already prioritise diversity, but this may not be widespread in FTSE 250 or 350 companies. The code whilst not legally binding, will require companies to pay closer attention to diversity and establish it as business driver, however it can only be successful if companies establish policy and practice to put it into action. An important part of the code is moving the focus of diversity beyond gender. Gender has been on an upward trajectory since the Davis Review, but this new code is broadening the scope of diversity to include other aspects such as social and ethnic backgrounds which is a very positive development. Gender may not necessarily bring diversity if the women and men on the Board are drawn from the same social and educational background and so looking beyond gender will further expand the pool.

10. 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.

Mercer does not support extending the Hampton-Alexander recommendation at this stage, given that the Hampton-Alexander recommendation is at the very early stages (having been outlined in November 2016). Mercer believes that it is too early at this point to consider extending the requirement beyond the FTSE 350. This should only be done when the output from the Hampton-Alexander requirements post 2020 have been released and examined.

11. 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.

2018 has seen the publication of many articles and research on the need to seriously address the under employment of people from racial and ethnic backgrounds. Even in the FTSE100 the approach to setting targets etc is mixed and progress has been slow.

The argument about lack of data is often put forward as a reason for doing nothing, but it is increasingly the norm in the UK for people to provide information on their racial or ethnic origin, for example it is widespread in the public sector (health, education etc) and becoming more common in private sector companies. Many FTSE 100 companies, Mercer included, have set targets to increase the number of people from racial and ethnic backgrounds. We are supportive of this proposal being implemented at this time but add that it would be helpful for legislation to be introduced in due course to support data collection for the UK albeit recognizing that workforces may be global.

Labour Force Statistics and the Census currently provide data on the racial/ethnic makeup of the population at national, regional and local level. This information can be used to support companies in understanding the pool of talent they can draw from.

Last year, the MacGregor Smith Review laid out a clear framework to help companies take a more data focused approach to this and set aspiration targets at executive level.

A diverse pipeline takes time to build and adding a requirement into the Corporate Governance Code of Practice will act as a much needed spur to start the process and take action

12. 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?

Mercer has no specific comments on this proposal.

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

Mercer has no specific comments on this proposal.

14. 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?

Mercer agrees that it is helpful for remuneration committees to have a strong awareness of remuneration arrangements across the workforce. Some remuneration committees already invest significant time in this and formalising this as best practice guidance in the Code would be a positive step. However, whilst management may appreciate access to remuneration committee advice and guidance on remuneration issues such as consistency, fairness, pay philosophy, alignment with the company strategy etc, the final decisions on pay deeper in the organisation should be left with management

As a result of a wider remit, remuneration committees may need a greater understanding of compensation arrangements. This may include an understanding of global compensation arrangements depending on how a global organisation is organised. There should be oversight of the general principles which drive all elements of compensation to ensure consistency, fairness and alignment with the company strategy.

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

Retention of Long Term Incentive Plans (LTIPs) supported by strong governance should help support long-term sustainable performance. It is critical that the remuneration committee can exercise discretion and use its judgement in the case of perverse outcomes (which will be minimised in a well-designed plan).

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

Yes, in principle. Mercer notes that recent experience is that it is difficult for remuneration committees to exercise upward discretion without risking triggering a vote 'Against'. Clearly, particular care is required with exercising upward discretion and, in our experience, remuneration committees take this very seriously and would generally only do so after full engagement with shareholders. For fairness it is important for it to be possible to exercise two-way discretion.

Questions 17 – 31 relate to the UK Stewardship Code Questions. Mercer shall be responding to these questions under separate cover by of Mercer Delegated Solutions Europe (DSE)

Additional

- Appendix A Section 5 Provision 32

In relation to the remuneration committee chair having to serve on a remuneration committee for at least 12 months before becoming a chair, Mercer supports this. Mercer understands this requirement to mean that the individual must have served for 12 months on any remuneration committee (as opposed to the remuneration committee on which they will become the chair) – this approach is positive as the individual needs to understand the corporate governance environment (which can be achieved by being on any remuneration committee).