

## UK CORPORATE GOVERNANCE CODE CONSULTATION

### FIDELIO PARTNERS' RESPONSE

#### INTRODUCTION

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#### EXPERIENCE AND PERSPECTIVE

Fidelio Partners conducts Board reviews in the UK and internationally and supports Chairs with regard to building Board capability, Board composition and Board succession planning. Fidelio is recognised for our understanding of shareholder and stakeholder expectations, as well as our work advising Boards on Diversity and Inclusion, climate change competence and embedding ESG. Our focus is building highly effective Boards that are well placed to discharge their duties and oversee value creation for shareholders and stakeholders.

Fidelio has been advising and supporting Boards since 2009 and conducting Board reviews since 2016. The breadth of our work and the extent of our experience provides a rounded perspective on Board effectiveness and Board performance.

Fidelio welcomes the current consultation on the UK Corporate Governance Code and in this document we are pleased to respond to the specific questions that have been raised.

#### SECTION 1: BOARD LEADERSHIP AND COMPANY PURPOSE

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*Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?*

The increased focus on the outcomes of good governance rather than a more generalised standard of effectiveness is to be welcomed. Consideration needs to be given to time horizons. Some, if not many, of the outcomes and certainly benefits of governance activity will accrue over the longer term and may not be immediately discernible. There is a risk that this Principle could shorten time horizons – definitions and guidance will be important.

*Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?*

Given the important contribution all businesses need to make to tackling climate change, it is incumbent on Boards to ensure that transition planning is embedded in strategy and this proposed amendment will support that.

*Q3: Do you have any comments on the other changes proposed to Section 1?*

Provision 3 is a good opportunity to encourage broader shareholder engagement by Committee Chairs – the reporting requirement could be still more explicit here.

## SECTION 2: DIVISION OF RESPONSIBILITIES

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*Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?*

A thorough Board evaluation review will already be taking this into account. This is certainly an important consideration in all Fidelio's Board reviews. We also agree that being overly prescriptive will not achieve the desired effect – the focus of the reporting needs to be on ensuring that the director can commit the time needed to the Board in question. External commitments take many forms, and it is for the Chair and individual director to give confidence that this issue, which is core to individual effectiveness, is being well managed.

*Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?*

As per the previous answer, external commitments can take many forms and it is important for shareholders to be able to build a rounded picture beyond non-executive directorships with other listed companies.

## SECTION 3: COMPOSITION, SUCCESSION AND EVALUATION

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### DIVERSITY AND INCLUSION

*Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?*

Yes. Some Boards still have a more reactive approach to composition and succession planning. Ensuring that the Nomination Committee is required to have Non-Executive and senior Executive succession plans in place that take full account of diversity should lead to a more a structured and strategic approach.

*Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?*

We agree with the approach but there is a risk that the value of cognitive diversity is being understated.

*Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?*

Yes. The alignment of composition to strategy has become more challenging but much more important in a fast-changing environment post-pandemic, high inflation environment. Fidelio finds that all the Boards we are working with are sharply focused on this point. Some Boards, however, remain unsure about the levers that are available to the Board to oversee and promote ED&I. Transparent reporting will share good practice and raise standards.

**BOARD PERFORMANCE REVIEWS**

*Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?*

Fidelio conducts Board reviews internationally including for a number of FTSE Boards and we support the proposed recommendations in particular the shift in focus to performance reviews. A number of Chairs that we are working with are keen to bring greater clarity to the concept of a high performing Board.

**SECTION 4: AUDIT, RISK AND INTERNAL CONTROL**

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**AUDIT AND ASSURANCE POLICY**

*Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?*

Yes.

**AUDIT COMMITTEES AND THE EXTERNAL AUDIT: MINIMUM STANDARDS**

*Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?*

Yes. There is an implicit requirement that the Audit Committee keeps up to speed on audit and control requirements. For this Committee a more explicit requirement may be of value.

**SUSTAINABILITY REPORTING**

*Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?*

Yes. This information is so important for shareholders and stakeholders and its robustness and integrity is of priority. The Audit Committee should have the skills to ensure that frameworks and processes are put in place to address this.

**RISK MANAGEMENT AND INTERNAL CONTROLS**

*Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?*

Yes.

*Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?*

It is preferable for the declaration to cover the entire period. The explanation of how the Board has reasonably concluded that systems are in place will inevitably need to reflect how the Board has built comfort on this point.

*Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?*

The definition of controls should be extended to reporting. The broader capture is important for shareholders and stakeholders.

*Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?*

Illustrative examples of best practice are of great value but should clearly not be prescriptive.

*Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?*

N/A

*Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?*

Aspects of risk management and internal controls that are of interest to shareholders but frequently not referenced include reputational risk and risks arising from AI.

## GOING CONCERN

*Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?*

Yes.

## RESILIENCE STATEMENT

*Q20: Do you agree that all Code companies should continue to report on their future prospects?*

Yes

*Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?*

Yes

## SECTION 5: REMUNERATION

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### CHANGES TO STRENGTHEN LINKS TO OVERALL CORPORATE PERFORMANCE

*Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?*

Yes, although there is scope for a more positive statement about the benefits of establishing a remuneration policy that effectively aligns interests and encourages behaviours and leadership that will promote value for shareholders and stakeholders. Fidelio also sees many Remuneration Committees already taking account of compensation across the company when determining executive director compensation. The latter cannot be seen in isolation, particularly in a cost of living crisis.

### MALUS AND CLAWBACK

*Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?*

Yes. This is an important clarification.

### CHANGES TO IMPROVE THE QUALITY OF REPORTING

*Q24: Do you agree with the proposed changes to Provisions 40 and 41?*

Yes.

*Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?*

Fidelio has found that the introduction of pay gap reporting has focused Boards' attention on structural inequalities within the company. We would recommend an explicit reference to how the Board approaches and reviews pay gaps and ratios within the company.

## OTHER MATTERS FOR CONSIDERATION

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### ARTIFICIAL INTELLIGENCE

*Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?*

Business will clearly be a key driver of AI and Fidelio has already [published our view](#) that Boards cannot wait for a governance and regulatory framework. Rather Boards need to be playing a role today developing their own oversight and governance frameworks and ensuring that AI is being applied responsibly within the organisation. Please see [Boards, Investors & Diversity Champions – Regulating AI](#). We recommend an explicit reference in the Code to responsible oversight of the application of technology and AI, including how the Board is approaching this.

