13/09/2023

UK Corporate Governance Code Review
Financial Reporting Council
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By email to: codereview@frc.org.uk

Dear Code Review Team

AustralianSuper welcomes the opportunity to provide feedback to the UK Financial Reporting Council's consultation on the UK Corporate Governance Code.

Background

AustralianSuper is Australia's largest superannuation fund, with over 3.2 million members, and we manage more than Au$300billion (£155 billion) in member assets under management. Our purpose is to help members achieve their best financial position in retirement.

We believe environmental, social and governance (ESG) factors have an important role in managing investment risk and opportunity. As such, consideration of ESG and Stewardship issues are integral to our investment process. As a long-term owner, we take an active interest in the quality of the corporate governance, sustainability and corporate social responsibility policies and practices of our investments.

We believe that companies with good ESG management are likely to provide better long-term returns. Exercising the rights and responsibilities of ownership on behalf of members is a core pillar of our ESG and Stewardship program.

We invest globally and have exposure to UK listed companies to which the UK Corporate Governance Code applies on a comply or explain basis. It follows that upholding standards of corporate governance is an important element of our investment stewardship role, including through responding to consultations on national corporate governance codes and other public policy work. We are consistent in our public policy submissions made across all global jurisdictions.

We are generally supportive of the proposed changes to the UK Corporate Governance Code and our responses to the consultation questions are set out as an appendix to this letter.

We trust our feedback is helpful and we would be pleased to provide additional information or to discuss our feedback in further detail.

Yours sincerely

[redacted]

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APPENDIX

UK Corporate Governance Code consultation: Response from AustralianSuper

Section 1 – Board leadership and company purpose

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

Yes. We agree with the changes to Principle D to include a new requirement that companies should, when reporting on their governance activity, focus on activities and outcomes to demonstrate the impact of their governance practices. This is welcome and necessary.

The changes strengthen Principle D which previously only focused on the board ensuring effective engagement with shareholders and stakeholders. Whilst engagement is important, it is the outcomes of governance practices which are material. In addition, engagement follows from the outcomes of governance practices.

These changes also reflect the shift in emphasis in the UK Stewardship Code 2020 that investors, as stewards of capital, focus on their stewardship activities and outcomes. Providing the same emphasis for companies is important, especially given (i) the critical role that boards and investors play in the stewardship of companies and (ii) governance activities, and their outcomes, underpin stewardship and the relations between investors and board directors.

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?

Yes. Climate change is one of the most significant issues facing investors and companies today and climate-related risks and opportunities will impact economies, asset classes, industries, societies and the environment. As such, climate change presents risks and opportunities for investments in our portfolio. AustralianSuper aims to manage the risks and opportunities of climate change, which we believe are likely to have a significant impact on members' investment returns, through our consideration of ESG issues in the investment process and stewardship activities.

AustralianSuper has committed to manage its investment portfolio to net zero carbon emissions by 2050. The commitment was made in members' best financial interests given the potential risk climate change presents to the Fund's long-term investment performance. Our net zero commitment builds on the actions we are taking to manage the transition and physical risks in the portfolio and our desire to produce outcomes that create and/or enhance companies' financial value. Our net zero 2050 commitment is also consistent with the scientific consensus of reductions required to meet the goals of the Paris Agreement as outlined by the Intergovernmental Panel on Climate Change (IPCC).[1]

We support the adoption of standardised, internationally-aligned disclosure of climate-related financial risks and opportunities in Australia. The overarching principle of high-quality disclosures which require transparent, credible, and comparable data will enable users of climate risk disclosures to make informed decisions. We believe the implementation of the standards in Australia will support our investment decision-making and stewardship activities.

It follows that we consider that boards of investee companies should report on the company's climate ambitions and transition planning, in the context of strategy, and the surrounding governance. The governance, management and oversight of sustainability risks and opportunities, including those in relation to the climate transition, are of fundamental importance to long-term investors.

[1] "Global Warming of 1.5°C", an IPCC special report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty. www.ipcc.ch/sr15

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

The changes are welcome, and we particularly support the inclusion of:

(i) a requirement that the board report on the embedding of the desired culture, and how effective this has been;
(ii) that the board reports in the annual report on the outcomes of engagement with shareholders and that this should be reported publicly
(iii) that the board should routinely review the effectiveness of the arrangements in place for the workforce to raise concerns in confidence.

Section 2 – Division of responsibilities

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?

Yes. Having the adequate time to devote to a directorship is an important governance consideration for investors and it is important that this issue is considered as part of the performance review of the board.

We consider that board performance reviews are an under-utilised governance mechanism. Reporting on the outcomes of board performance reviews could be much more effective, especially in how the board has responded to the results. A robust board performance review can also provide comfort to shareholders that the board is working effectively. This also links to the new Principle in Section 1 of the Code with respect to the board reporting on the outcomes of their governance activities.

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?

We agree with the changes to Provision 15 and welcome the requirements that all significant director appointments be listed in the annual report, with a description on how each director has sufficient time to undertake their role effectively in light of commitments to other organisations. We particularly welcome that the Provision will expect the disclosure of any actions taken as a result of this assessment on time commitments.

We would observe that the underlying issue of directors dedicating sufficient time to undertake their duties effectively will not automatically be solved by increasing disclosure and transparency. However the proposed change will aid both boards and investors in their engagement on this issue, and we will continue to advocate that directors do not over-commit themselves and that they maintain sufficient capacity to fulfil their roles, taking into account competing commitments. In instances where we believe that a director has not adequately fulfilled their duty to shareholders on their accountability for the strategic direction and performance of the company, the oversight of risk management and the appointment of the CEO, we may vote against such directors.

Section 3 – Composition, succession and evaluation

Diversity and inclusion

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

We agree that the proposals effectively strengthen and support existing regulations in this area. It makes sense that the changes are intended to strengthen the Corporate Governance Code on diversity and inclusion and support the Financial Conduct Authority's Policy Statement requirements on diversity and inclusion for company boards and executive management without introducing additional, duplicative targets or regulations.

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 support these changes as we consider that all identity characteristics of diversity are important and contribute to cognitive diversity and inclusive cultures.

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

We support the changes to Provision 24 in relation to the annual report describing the work of the nomination committee, including in relation to succession planning and diversity and inclusion.
We welcome the emphasis on succession planning for both board and senior management positions and the development of a diverse pipeline of talent. Succession planning is a material governance risk and we note that the Financial Reporting Council's annual reviews continue to identify poor reporting on companies' approaches to succession planning, where most reporting is from a reactive rather than proactive basis. We support improving reporting in this area, which should drive increased focus on this area and better outcomes.

We welcome the aim to improve transparency to understand the role of any targets or initiatives companies have chosen to use to achieve greater diversity and inclusion in their boards and executive management. The changes will also align with the Financial Conduct Authority's requirements on diversity and inclusion for listed companies to further encourage adoption, rather than duplicating them.

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?

We support the proposed adoption of the recommendations from the Chartered Governance Institute (CGI) in relation to board performance reviews.

A change in the nomenclature from 'board evaluation' to 'board performance review' is sensible and will, hopefully, lead to reviews becoming more valuable by 'informing a continual process of self-improvement for boards' rather than being used as 'a backwards-looking assurance function.'

We consider that the change in wording to new Provision 22 that the board chair should "commission", rather than consider having, a board performance review, is an important shift in emphasising the importance of board reviews. The reporting on the reviews, and the outcome, are an important governance mechanism for stakeholders, including shareholders, and offer rich insights for engagement. Including guidance for reporting is welcome.

Section 4 – Audit, risk and internal control

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?

We agree that all Code companies prepare an Audit and Assurance Policy on a 'comply or explain' basis.

The UK Government has set out its plans to introduce a requirement that Public Interest Entities (PIEs), being companies which have 750 or more employees and a turnover of £750 million or more, produce in the annual report (i) an Audit and Assurance Policy (AAP) on a triennial basis and (ii) an annual implementation report on the AAP. We agree that the Audit Committee should have responsibility for developing the AAP and that this should be included in the UK Corporate Governance Code. We believe that it is appropriate that the Code make this a requirement for all companies to ensure that there is no distinction between PIE companies and other companies on this important requirement.

We agree that the Audit Committee should take the lead in engaging with shareholders and wider stakeholders in relation to the AAP and other audit related matters. Engagement with Audit Committees is fundamentally important for shareholders and we would encourage more interaction between the Audit Committee and investors.

Audit Committees and the External Audit: Minimum Standard

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?

We agree with the amendments referring Code companies to the Minimum Standard for Audit Committees as an effective way to implement such expectations and align with them whilst avoiding duplication.

We agree that, for non-FTSE 350 companies where the Minimum Standard does not automatically apply, inclusion in the UK Corporate Governance Code of this requirement on a comply or explain basis is appropriate, especially given two sections of the Minimum Standard were previously included in the Code.

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?

We agree with the expansion to the remit of Audit Committees, especially in circumstances where such matters are not reserved for the board. Oversight by Audit Committees, and the board more generally, of narrative reporting, including sustainability reporting and the assurance of ESG metrics, is very important.

This change would be very beneficial as it would bring the narrative (and sustainability) reporting and ESG metrics under the auspices of the Audit Committee. This would drive better and more informed engagement between audit committees and shareholders.

However, we would emphasise that the audit committee needs to maintain focus on the fundamental role of the external audit, on the basis of the assurance it provides to investors. We would not want to see the expansion of the audit committee’s remit distract from its primary focus on the oversight of the external audit.

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?

We consider that the proposed amendments strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way. We particularly support the overall emphasis on the Code strengthening board accountability and reporting in relation to internal controls.

We note that the UK Government requested the inclusion of a requirement for an explicit directors’ statement regarding the effectiveness of the company’s internal controls, including financial reporting, but also the inclusion of wider operational and compliance risks and the basis of assessment.

We support including a provision that the board declare whether they can reasonably conclude that the company’s risk management and internal control systems - including material operational, reporting and compliance controls - have been effective through the reporting period and up to the date of the approval of the annual report by the directors.

We support encouraging the review be approached as a continuous monitoring process to maintain the effectiveness of systems rather than as a one-off exercise.

We agree that it is appropriate that the revised Guidance on Risk Management, Internal Control and Related Financial and Business Reporting will discuss what may constitute a material weakness. However, it will ultimately be for the board to determine which weaknesses are material to their specific situation and should be reported in the annual report.

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.

We consider that the board's declaration should be based on continuous monitoring.

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?

We consider that the change should be from 'financial' to 'financial including narrative reporting' to ensure all material controls are considered. We understand that the genesis of this change relates to the fact that the Financial Reporting Council's stakeholder engagement emphasises that narrative reporting increasingly includes materially important information, in the context of each company, which is used by investors for capital allocation decisions and the importance of narrative reporting in relation on strategy, principal risks, corporate governance and environmental and social matters. However, to lose the reference to 'financial' would be detrimental and could potentially de-emphasise the financial materiality of risks and opportunities that come under the auspices of narrative reporting.

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?

We consider that it would be helpful for the guidance to set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems. However, this guidance should not be prescriptive. It is ultimately for the board and executive committee to decide whether the review of the effectiveness of the risk management and internal control systems is appropriate.

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?

Our view is that individual companies and boards are best placed to decide what constitutes (i) an effective risk management and internal controls system and (ii) a material weakness. Over-prescription in this area could lead to boards and companies overlooking a material risk based on their individual circumstances etc.

As the consultation paper states: 'the board will need to be comfortable that the internal controls framework is sufficiently effective to enable them to make the declaration.'

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

We have no additional comments.

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. We agree that it is important to retain current Provision 30. The concept of ‘going concern’ should continue to apply to all companies subject to the UK Corporate Governance Code, including those companies that do not meet the definition of PIE.

Resilience Statement

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

Yes. We agree that all Code companies should continue to report on their future prospects.

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, we agree, especially given the Code’s requirements apply on a ‘comply or explain’ basis, with a heavy emphasis on compliance.

The requirement for PIE companies to produce a Resilience Statement, setting out their approach to managing risk and developing resilience over the short, medium and long term was already covered by an existing provision in the Code for a viability statement. Given the importance of such statements on resilience and viability, we support that the Code encourages this to apply to non-PIE Code companies on a comply or explain basis.

Section 5 – Remuneration

Changes to strengthen links to overall corporate performance

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

Yes. We agree that the proposed revisions will strengthen the links between remuneration policy and corporate performance. It is particularly important that new Provision P specifically states:

Remuneration outcomes should be clearly aligned to company performance, purpose and values, and the successful delivery of the company’s long-term strategy including environmental, social and governance objectives.

We also welcome the new Principle Q and the specific inclusion of a reference to company and workforce pay and conditions as a factor which remuneration committees should have regard to when determining executive pay. Consideration of such factors acts as an important reference point for deliberations on executive pay and making this more explicit in the Code will be beneficial. This is also an increasing area of focus for engagement between investors and remuneration committees so having more clarity on disclosures in this area is welcome.

Malus and clawback

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

Yes. We agree with the proposed reporting changes. We believe the changes should deliver improved transparency for investors by providing greater visibility of malus and clawback mechanisms available to address scenarios involving serious failings, and whether and how the companies are making use of these.

We expect that improved transparency might also shine a spotlight on situations where malus and clawback provisions do apply and where they should apply but currently do not. For example, ESG related incidents and wider cultural measures tend not to appear in malus and clawback provisions in either short or long-term incentive plans.

Changes to improve the quality of reporting

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

Yes. We agree that the proposed changes are appropriate to deliver more bespoke reporting on remuneration structures and link to strategy, and to minimise the risks of boilerplate reporting by companies, which the current version of Provisions 40 and 41 are causing.

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

We believe that the reference to pay gaps and pay ratios should be strengthened per the suggestion that companies be asked to report on the measures being implemented to reduce and eliminate pay gaps within their organisations.

Other areas for consideration

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?

We note that the UK Government published a White Paper on artificial intelligence (AI) in March 2023. This recommends a new AI regulatory framework be implemented underpinned by five values-focused cross-sectoral principles:

- Safety, security and robustness
- Appropriate transparency and explainability
- Fairness
- Accountability and governance
- Contestability and redress

We believe that boards should have oversight of how companies comply with new regulations and manage their strategic and emerging risks. In relation to AI, we believe boards are responsible for ensuring companies are using technologies appropriately, responsibly and sustainably. The board should be informed of the impact on the company's culture resulting from the introduction and use of AI.