Responses to the FRC’s questions on the proposed reforms to the UK Corporate Governance Code

Below are Crest Nicholson’s responses to the FRC’s questions relating to their consultation paper on the proposed reforms to the UK Corporate Governance Code.

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, this is in keeping with the direction of travel of corporate reporting to ensure it doesn't become a boilerplate process, but it will be important to establish the assurance required for non-financially audited outcomes, and guidance in this area would be welcome.*

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, this is a global risk, but reporting should be proportionate, not excessive, and must avoid duplication with existing climate related disclosures e.g. TCFD. We already produce a significant amount of reporting in relation to ESG and we are not convinced that additional reporting driven by the Code is necessary. We think it would be sufficient to cross-reference to the TCFD report.*

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

> *No further comments*

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, this would be a good addition as the current focus is only on listed appointments, and it would be good to give a more complete view.*

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?

> *Overall we agree, but we have concerns around the practicality of reporting commitments, as these change depending on the needs of the business. We think it is sensible to consider all directors’ commitments for board performance reviews and we agree that all significant appointments should be listed in the Annual Report, however we don’t believe that it is necessary or practical to include excessive detail, e.g. actual time commitments.*

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?

Overall, we consider that having two sets of regulations in this area (i.e. the FCA Policy Statement and the Code) is unwelcome and we are not convinced that the Code should be the driver of D&I reporting. Any amendments must avoid duplication/repetition.

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 fully support the capturing of a wider range of diversity characteristics in terms of expanding the pool that board member candidates are sourced from. However, appointment from that pool should be based on merit, taking into consideration the objectives of the organisation, and care should be taken to avoid the risk of board sizes increasing too much.

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

Overall we support these changes, but as previously mentioned, any amendments must avoid duplication and standardisation of reporting. It is also important to be aware of the impact that disclosure of the succession planning process might have on existing employees.

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?

Overall yes, but we believe there should be an impact assessment of these changes to fully understand the additional reporting requirements and whether these are practical and useful. In addition, we think that the frequency of independent external board performance reviews should remain at every 3 years.

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?

Overall yes. Comply or explain provides the flexibility for smaller listed companies to opt out, but this proposal would at least require them to consider compliance. Also, the AAP links directly with the Internal Control Framework, which is a new Code requirement, and therefore it makes sense to include. Additional guidance on what good looks like would be welcome to avoid this becoming a boiler plate exercise.

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?

> *Yes, reference to the Minimum Standard document avoids duplicating the standards within the Code. However, we believe it would be even more efficient to have just one full set of standards included within 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?

> *The review of narrative reporting should not fall to the audit committee by default and the responsibility for this should be a board decision. It is however appropriate that some assurance work is undertaken in these areas, and this should be described in the AAP. Guidance on what good looks like in this area would be welcome to ensure that the workload is proportionate and value adding.*

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?

> *In principle yes, but further clarification and guidance is required in many aspects. Internal control systems should remain risk based and pick up on the many learnings with US SOx. We are concerned that the proposed amendments require a large amount of extra work to operate and monitor an expanded internal control framework, and we would prefer to see this being introduced using a phased approach.*

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 declaration should be based on continuous monitoring throughout the reporting period and up to the balance sheet date only. We consider it impractical to declare up to the Annual Report publication date.*

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?

> *Yes, but again with the caveat of carefully managing the impact of the extra workload and timescales for implementation. It is a big to ask to have this in place in 16 months' time. The guidance in this area should be comprehensive.*

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?

> *This would be very helpful to avoid businesses referring to US SOx for examples.*

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?

A material weakness should be anything that would be both materially damaging to the company and significantly affect its future prospects. However further guidance on this and what constitutes an effective control framework is essential.

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

As well as comprehensive guidance on the changes to the Code, we would like to understand your expectations in relation to the production of the Resilience Statement and the Audit & Assurance Policy and how these link with the Code. For example, guidance on stakeholder (shareholder) review of the AAP would be helpful.

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. This is such a well-established principle that we would not want to see it replaced with something potentially more confusing.

Resilience Statement

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

Yes we agree. We think that investors find this reporting helpful.

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.

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?

Our view is that, whilst important, these amendments would add little value. This is already a heavily regulated area and a key principle in the Code, and the link between the remuneration policy and corporate performance is already quite strong.

Malus and clawback

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

We generally consider this to be a positive change as it would set a minimum standard for companies and provide consistency across reports. However, it wasn't clear to us why a 5-year reporting horizon has been proposed, and we would not advocate for naming the director(s) involved (even though this was not explicitly proposed) for confidentiality reasons.

Changes to improve the quality of reporting

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

> *These changes seem sensible to us; however, we are concerned about the impact they would have on the volume of remuneration reporting in the Annual Report, which is already quite heavy.*

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

> *We believe that the reference should be removed to avoid duplication. Pay ratios and a gender pay report are already published on our website, so this can be cross referenced.*

Other matters 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?

> *Since AI represents both an opportunity and risk, we would expect it to be referenced in the Annual Report of most listed companies going forward. Guidance in this area would be helpful, but we don't believe it requires specific treatment in the Code.*

In summary

We believe most of your proposed changes are sensible in principle, but we have some significant concerns around proportionality and timing. We consider that an impact assessment would be beneficial to better understand the extra cost and workload for companies, and we think a more phased approach to implementation is needed. The additional workload your proposals would have on smaller listed companies should also be considered, as we note that they do not differentiate between a FTSE 100 and a FTSE 350 company.

Every year we see longer Annual Reports being produced and we are concerned that informative data is being lost in the expanding reams of narrative. It would be a worthwhile exercise to critically look at this narrative and propose items that companies could stop producing. For example, ESG reporting is currently too data heavy, and this can detract from the real risks and issues.

We understand that mandatory external assurance over the enhanced internal control framework is not being proposed, and we agree with that, but we are concerned that this could eventually be the de facto requirement for many companies to ensure they remain competitive in the financial market. These proposals carry the risk of edging us closer to the entire Annual Report being subject to an external audit, which would clearly be cost and time prohibitive.

Furthermore, to continue to print Annual Reports using, ink, water, and energy, with a sustainability section that is growing every year, is an anachronism and risks undermining the credibility of the document. We think that Annual Reports should be produced exclusively as digital content going forward.

Finally, we look forward to receiving the final amended Code and your comprehensive guidance, particularly in the areas of audit, risk, and control. The UK Listing Reform is seeking to ease restrictions and encourage PLCs to list in the UK, and it is important that your proposed changes are aligned with the spirit of this reform to help encourage future investment.