

Financial Reporting Council
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13 September 2023

Sent via email to: codereview@frc.org.uk

To Whom It May Concern,

RHI Magnesita N.V welcomes the opportunity to comment on the FRC's Consultation: UK Corporate Governance Code published in May 2023.

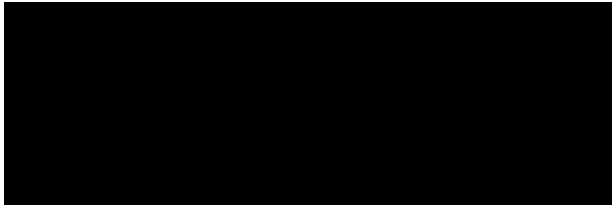
Please find enclosed RHI Magnesita N.V.'s response to the above consultation. We have responded to it as a UK listed company and hope that our viewpoint is constructive and helpful.

We are happy that our responses be made publicly available, without identifying information and we would like to be contacted when the consultation response is published.

If any further information or clarification is required, please let me know.

Kind regards,

Sally



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Introduction

We support the overall aims of the FRC in improving the quality of governance for UK listed companies and delivering transparency to the market and wider stakeholders but note that the proposals for the UK Corporate Governance Code (the “Code”) do not address the greater need to improve Audit Quality and, at present, it is unclear how the potentially significant cost in the expansion of reporting requirements justifies the benefit.

General comments

The proposal to introduce a **declaration by directors on the risk management and internal control** frameworks, as it currently stands, will be an **excessive burden** on management and boards. Given the proposed near-term timeframe for implementation, the lack of clarifying guidance, the simultaneous widening scope of non-financial reporting, and, crucially, the **absence of any cost-benefit analysis**, we would be unable to support the proposal as it currently stands, without any clarifying guidance.

The intention to **codify the principle of comply or explain** within the Code itself is a sensible approach.

The greater focus on **ESG and non-financial data** appropriately reflects stakeholders’ concerns and contributes to the wider societal needs. However, the definition of which board committee is responsible for narrative, particularly sustainability, reporting (Provision 27 in the proposed Code) should be reconsidered; **boards should be able to delegate** to the appropriate internal body based on the skills and experience particular to the company.

Specifically, we would recommend, from the perspective of being a non-UK incorporated, UK Listed company (subject to the UK Code, but not to UK Companies Act), that the Code should be definitive on whether a **Code company should prepare an Audit & Assurance Policy** (AAP) (or explain) and not make indirect references within Audit Committee responsibilities and footnotes linking to legislation. The indirect reference to section 172 in the 2018 Code created uncertainty on what constituted compliance and what UK focused investors expected. The Code should be explicitly aligned with regulations on such key and tangible governance matters and **require companies to implement an AAP**. We would link this point to the recent review of the attractiveness of the UK Listing environment; clarity, aligned with investors’ expectations, would be beneficial. In its current form, the Code has a narrow view of companies which are UK-listed and does not reflect the international mindset that the LSE would no doubt prefer to engender.

It should also be recognised that there is a significant burden on companies in **non-financial reporting incoming in the same period**, not only from the secondary legislation of the UK Government but legislation such as Corporate Sustainability Reporting Directive and Corporate Sustainability Due Diligence Directive affecting those with European operations and reporting obligations. More work is required to ensure that proposed changes to the Code are fully aligned with, and complement, other corporate reforms, and initiatives.

Adding disclosures without any reduction will add to the burden of reporting (both cost and time spent) and also risks making **annual reports so unwieldy** as to be less useful to end-users.

Specific comments pertaining to provisions or consultation questions.

To provide comment on specific provisions of the draft Code we would note:

1. *Risk management and internal controls*

(Relevant consultation questions 13, 14, 15, 16, 17, 18)

Requiring the board to make a declaration on the effectiveness of risk management and internal controls will certainly focus the attention of the directors and may be argued to strengthen risk management and internal controls. However, we have significant concerns on the implementation, based on the information available to us.

Warping of the independent non-executive role

The non-executive directors are positioned to oversee, challenge and guide management. Extending this role to include monitoring and reviewing management's control systems and being responsible for reporting on remedial actions will make it difficult to maintain the distance required for that independent constructive challenge which is at the heart of the non-executive role. Not only does it blur the lines, but it is also unrealistic to expect that the board will be able to dedicate the time to do this assessment, based on the current non-executive role structure, unless the guidance can clarify and specify what a baseline looks like. We are currently unclear if external assurance is permitted under the Code, or if it will be expected that the directors will dig deeper into the business to assess, based on their own experience, whether the systems are sufficient.

External assurance

That said, it is likely that there will be significant reliance on external audit or consultancy firms to provide assurance to the board to make the declaration. The capacity of the extant firms is unclear, considering the conflicts of interest which are likely to occur, likely driving up prices through limited demand. The quality of assurance as new entrants come in should also be considered.

These third parties will not be able to be held to account for their assessment of such non-financial and internal controls data (being less quantitative than would be in a normal audit), reducing the ability of boards and stakeholders to rely on the assurance, therefore potentially not adding true benefit, whilst adding significantly to the cost of being a Code compliant company.

Cost

In straitened times, this declaration and the associated assurance would likely re-direct the limited funds of companies and generate unnecessary discontent with the UK governance approach (linked with the previously referred to examination of the competitiveness and attractiveness of a UK listing). If the guidance states that external assurance is surplus to requirements and it comes too late, it will be difficult for companies to row back from the external assurance and could have allocated capital unwisely. If external assurance is expected, this cost will be substantial, and it is unclear how much benefit and comfort this will give stakeholders.

Monitoring date

We disagree with the proposed continuous monitoring as part of the declaration on internal controls and risk management. Management should be continuously monitoring and the board's role in this regard is to appoint suitable persons to complete this, with a regular check as to the effectiveness of it.

No guidance available

It is difficult to opine on the declaration proposed, without the referenced guidance. We note that the FRC guidance, published in 2021, led to companies reversing compliance statements on Provision 40 and 41 in the 2018 Code.

Guidance needs to address the potential for lack of comparability about what constitutes effective risk management and internal control systems. There should be a minimum baseline of processes outlined in the guidance in order to declare effectiveness. How this will be possible, given the variety of companies included in the scope, is unclear, which further presents this proposed change as unrealistic in achievement. If implemented in this way it could undermine the reputation of the UK Code and governance system, resulting in vague and unsubstantiated declarations, giving false comfort to users of the annual reports.

Given the significance of the declaration, if it is implemented post-consultation, we would prefer that it be tailored to address each aspect i.e., separately assessing and reporting on each of risk management, financial reporting, non-financial reporting, operating and compliance. This would recognise the journey that companies will have to go on initially and recognise the different strengths and risks of each area within a company.

Other suggestions would be the improvement of specific narrative on the steps taken by the board to assess these systems in place of a declaration or if it will be implemented regardless of feedback, a staggered implementation of such a big disclosure, giving companies time to adjust to stakeholders' feedback and manage the costs.

2. *Narrative reporting and non-financial metrics*

(Relevant consultation questions 2, 12)

Extension of the scope of controls to non-financial data is supported as it will meet more of the needs of stakeholders. Given the importance to the world and its economies at the present time, the additional emphasis on climate is justified. 'Sustainability matters' should however be clearly defined within the Code to ensure consistent understanding and reduce the possibility that it is undermined as a concept through misuse.

As we refer to in our general comments, it is too prescriptive to allocate the oversight of narrative reporting to Audit Committee; boards should be free to choose based on the specialisms available.

3. *Interaction with the Government's proposed secondary legislation on reporting measures*

(Relevant consultation questions 10, 19, 20, 21)

We support the resilience statement, noting there is a multiplicity of assessments about the future of the company to manage (Going Concern, Viability statement and resilience statement). Investors are keen to hear about the criticality of outlook and future expectations for the business. Furthermore, such resilience analysis informs our strategic approach so giving valuable outcomes and long-term, sustainable performance.

As highlighted in our general comments, we would appreciate a definitive position on the implementation of an AAP by all Code companies.

4. *Director appointments, succession plans and board performance reviews*

(Relevant consultation questions 4, 5, 6, 7, 8, 9)

We support the change in terminology to 'performance reviews' and removal of 'consider having' is helpful to provide clarity.

The attempt to find consistency in the assessment of overboarding is welcomed. Including in the board performance review for the individual and their peers to assess their capacity seems sensible to generate internal conversations. It seems however unrealistic to expect anything other than boilerplate disclosures on this topic, given the impact on re-election at the AGM and the sensitivity of publishing peer review commentary on directors.

We support less prescriptive diversity characteristics, so that Code companies are free to reflect their priorities and position, capturing wider characteristics. For example, being headquartered in central Europe has a different local population than the UK and it is more helpful for the Code to be encouraging of diversity without being prescriptive, which, if followed to the letter, could result in an artificial position out of sync with a company's environment. The UK Listing Rules on diversity already require specific reporting on defined characteristics so it is positive this is not repeated.

5. *Other changes*

(Relevant consultation questions 1, 11)

With reference to governance reporting focused on outcomes- we would highlight that good governance can often achieve outcomes over a longer time frame than can be captured in annual reporting and these outcomes are rarely discrete results of governance activity. Therefore, the value of adding this and the ability to comply seems limited as a result of being too intangible.

We do not consider that the change to Provision 3, on shareholder engagement, is necessary given the well-established reporting on shareholder engagement, as part of stakeholder engagement reporting. It also does not reflect that the real challenge with shareholder engagement for most committee chairs is the lack of appetite from the investment community. This proposed change shifts the onus and blame on chairs if there is no engagement within the year reported on, which is unfair.

Similarly, we feel it is not advisable to state in Provision 26 that the Audit Committee is expected to engage with stakeholders on the matters described. We note that it is often difficult to get two-way engagement, requiring both parties to be motivated. Stakeholders should also be able to define which are the issues which matter to them, not those defined in the Code. If this aspect must be maintained, we would recommend the wording is adjusted to "Audit Committees... should **seek to engage**".

We would suggest that Provision 5 be amended to refer to 'other stakeholders and shareholders.' This change should avoid the misconception that reporting on shareholder engagement requires separate disclosure from that currently addressed through s.172 reporting.

Conclusion

We support the overall objective to enhance governance of key UK companies and hope our input outlined herein for your consideration would help to find balance between improving governance and reporting outcomes whilst ensuring the burden is not so onerous as to make a whole industry out of governance. It should be an integral part, not a standalone aspect, in running an effective and long-term, sustainably, successful business.