Annual Report

Financial Reporting Council

January 2015

Developments in Corporate Governance and Stewardship 2014

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Introduction

This is the first corporate governance and stewardship monitoring report to be issued under my chairmanship of the FRC. After eight months, my assessment is that while there are still areas that need improvement, there has been much to celebrate.

The UK's strong governance culture encourages companies to list in London and provides assurance to investors that the information they receive from boards is fair, balanced and understandable.

There has been an increase in compliance with the UK Corporate Governance Code. While this remains encouraging I remind companies who have chosen not to comply that explanations should fully describe and explain their thinking.

The UK is on course to reach Lord Davies' target of 25 per cent of women directors in the FTSE 100 in 2015 and, after some slow-down, the percentage of female executive directors has started to rise. There have also been improvements in the quality of disclosures by Audit Committees and more companies are now retendering their external audit contracts.

Users of the Code tell us that there is a balance to be found between addressing emerging governance issues, while giving enough time for recent changes to take effect. The 2014 updates to the Code introduced new requirements for risk management and reporting, and amended the remuneration sections – all aimed at encouraging boards to look further ahead and to be more accountable to shareholders. It is important that we give these changes time to bed down before we comment on their success.

The governance of individual companies depends crucially on culture. Unfortunately we still see examples of governance failings. Boards have responsibility for shaping the culture, both within the boardroom and across the organisation as a whole and that requires constant vigilance. This is not an easy task. Our recent guidance on risk management highlighted the need for boards to think hard about assessing whether the culture practised within the company is in line with what they espouse. Boards should consider what assurance they have around culture. Are performance drivers and values consistent? How can culture be maintained under pressure and through change? Is the culture followed consistently throughout the business? We will be working to promote best practice in these areas during 2015.

The risk management guidance also reinforced the need for boards to be frank about their capabilities to address the threats to the long-term success of the company, which includes threats arising from behaviour in the company.

The Code recommends that boards be a place of constructive challenge. Shareholders should provide a similar challenge. Looking at the UK Stewardship Code, with close to 300 signatories, there is the potential for a critical mass of oversight and engagement. There are signs too, that following the UK Stewardship Code has become best practice, with mandates increasingly referring to stewardship and reports of better proactive engagement by companies and investors over the 2014 AGM season. However, despite these improvements, too many signatories fail to follow-through on their commitment to the Code. Asset managers should not sign-up just to tick a box, but to commit to adopting and reporting against the principles of the UK Stewardship Code with appropriate explanations where needed.

We also hear mixed reports about the role of some proxy advisors. Although these organisations provide a valuable service to investors in analysing company governance and performance and so can support the principles of the UK Stewardship Code, it is essential that their advice takes full account of company circumstances and explanations, and is based on the same level of engagement as is expected of their clients.

More information about our findings and overall assessment is given in the rest of this report. The FRC would like to thank those organisations which have researched and published governance reports and those that have surveyed their members and collated data on our behalf. This information is important in informing and complementing ongoing discussions we have with investors, companies and other market participants.

In 2015 the FRC will reflect on the issue of company culture and behaviours (including in relation to the European Commission's Recommendation on the quality of corporate governance reporting); the application of the UK Stewardship Code (and the impact of the Shareholder Rights Directive); and the role of proxy advisors. Further analysis in these areas will help us to build greater confidence in listed companies. We need to reinforce a virtuous circle of long-term, sustainable returns attracting capital which drives further investment and supports economic growth that creates demonstrable value for the real economy. This is a powerful way in which capital markets can safeguard the support of the public, and the UK can maintain its hard-earned reputation for high quality corporate governance and reporting.

SIR WINFRIED BISCHOFF
Chairman, Financial Reporting Council
January 2015

Overview and Assessment

This report has four main purposes: to give an assessment of corporate governance and stewardship in the UK; to report on the quality of compliance with, and reporting against, the two Codes; to give our findings on the quality of engagement between companies and shareholders; and to indicate to the market where we would like to see changes in governance behaviour or reporting. In addition, the report summarises and comments on other relevant developments over the last 12 months, such as changes to the regulatory framework.

From the evidence we have reviewed, the FRC believes that the overall quality of corporate governance in the UK is high. The UK is a market which attracts capital as a result of confidence in a sound governance framework and associated practices, combined with flexibility and the ability to innovate. In making this overall assessment the FRC is aware that some poor practices remain which can trigger major failings in governance, with negative consequences for companies, shareholders and the UK market as a whole.

It is too easy to overlook the progress which has been made in improving governance over the 22 years of the UK Corporate Governance Code's existence. While a high level of compliance is to be welcomed, the FRC does not wish to preside over a culture of compliance where 'box ticking' is preferable to thoughtful consideration of the Code's provisions. This detracts from good governance.

The detailed assessment that follows in the remainder of this report draws on new and publicly available research, studies of annual reports and the UK Stewardship Code statements, as well as conversations with companies, investors and other interested parties. The FRC would like to thank everyone who has directly or indirectly contributed to the report.

Company Culture

No governance framework can eliminate risk and nor should it seek to do so. The difficult question of what represents an acceptable level of corporate failure will always be with us, but this does not mean that we should be complacent. We should continue to seek new ways to prevent and deal with poor governance practice. It is for this reason that we introduced references – in the preface to the Code and in the associated risk guidance – to the issue of establishing high standards of behaviour in terms of culture, values and ethics in the boardroom, and how these behaviours are transmitted and taken up throughout companies.

The development and promotion of such behaviours is a wider issue than amending or introducing new Code provisions. During 2015 the FRC will assess how effective boards are at establishing company culture and practices and embedding good corporate behaviour, and will consider whether there is a need for promoting best practice.

The UK Corporate Governance Code

Companies are continuing to respond in a positive manner to the provisions introduced in September 2012. Compliance with the Code remains high, with – for the first time – over 90 per cent of FTSE 350 companies reporting that they were either complying with all, or all but one or two, of its provisions.[1]

1 Plotting a new course to improved governance; Grant Thornton; December 2014

In 2012, the FRC set out criteria for clear explanations, and in this report we continue to assess performance against these criteria. The results remain mixed, with some companies seemingly unwilling to address the spirit and practice of good quality explanations. The FRC has no desire for the Code to be viewed as a rulebook, and in 2015 the FRC will re-emphasise the value of 'comply or explain' in achieving good governance. This will assist with the implementation of the European Commission's Recommendation on the quality of corporate governance reporting which was published in April 2014.

Last year the FRC announced a project on succession planning with the aim of identifying and spreading good practice in succession planning and on how the nomination committee can play its role effectively. We intend to publish a discussion document in the Spring which will include our initial findings and request views on these. In the meantime we will continue to hold meetings and roundtables with key stakeholders and undertake other research.

The UK Stewardship Code

Our chief aim remains to foster a better quality of engagement between companies and investors, which will assist in delivering better company performance and thus better returns to investors. As was the case last year, we hear encouraging news from larger companies and major investors that more engagement on a wider range of issues is occurring. But we are still not reassured that this is taking place across the listed sector with sufficient quality. We are concerned that too many signatories to the Code do not do what they have signed up to do. The standard of reporting by signatories remains variable and building a body of evidence about the engagement which is taking place in practice is not straightforward. The activities of the Investor Forum in this area will be important and the FRC will continue to work with the Forum in its efforts to create an effective model for collective engagement with UK companies.

During the first half of 2015, the FRC will begin a project to study how best we can promote a culture of stewardship and its benefits; and how we can increase our scrutiny of adherence to the Code in order to improve the quality of practice and reporting.

Proxy Advisors

We continue to receive mixed reports about the quality of reporting, engagement and voting outcomes which result from the relationship between some proxy advisors and their clients.

The themes in these reports are very familiar. Proxy Advisors are accused of taking a 'tick-box' approach to governance, with inadequate consideration of company circumstances and explanations, combined with a lack of engagement which should assist with their understanding of why a company has taken a particular approach. Asset managers and owners are charged with accepting advice and voting without proper consideration.

With such misunderstandings – or perceptions of poor communication – continuing, the FRC will consider what role it can play in improving engagement and communication between all concerned.

Other Developments in Corporate Governance

This section summarises the most relevant activities in 2014 for corporate governance and stewardship, and indicates the further developments that are expected in 2015.

Audit Directive and Regulation

On 18 December 2014 the FRC issued a consultation on options for amending its framework of auditing and ethical standards for auditors to give effect to the EU Audit Directive and Regulation.[2] The Department for Business, Innovation and Skills (BIS) is also seeking views on the implementation.[3] The new requirements come into effect on 17 June 2016 and apply to financial years starting on or after that date.

In its final report on the market for audit services in FTSE 350 companies, published in October 2013, the Competition Commission – now the Competition and Markets Authority – made a number of recommendations to the FRC.[4] It also introduced some new mandatory requirements from 1 January 2015. Both have potential implications for the Code. The FRC has deferred consideration of whether to amend the Code until the next review in 2016. This will enable the FRC to take account of the final Orders and new legislative requirements resulting from the Directive and Regulation, as well as the impact of the changes that were made to the Code in 2012.

European Commission's Recommendation on the quality of corporate governance reporting (the 'comply or explain' principle)

The Recommendation, published in April 2014, aims to improve the overall quality of companies' corporate governance statements and, specifically, the quality of explanations provided when corporate governance code recommendations are not followed.[5] Member States are required to make the Commission aware of their arrangements by mid-April 2015 and the FRC will respond on behalf of the UK.

The Commission made a number of proposals about the information required in corporate governance statements. This included that the information is sufficiently clear, accurate and comprehensive thereby enabling shareholders, investors and other stakeholders to gain a good understanding of the manner in which the company is governed. Companies should, in particular, clearly state which code provisions they have departed from, report on why and how the decision was made and include any mitigating measures.

European Commission's Shareholder Rights Directive

It is expected that negotiations of the draft Shareholder Rights Directive[6] will be concluded in 2015. The draft directive includes an article, implemented on a 'comply or explain' basis, requiring institutional investors to develop an engagement policy outlining how they engage with the companies in which they invest.

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2 Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; European Parliament and of the Council; April 2014

3 Auditor Regulation – Discussion document on the implications of the EU and wider reforms; BIS; December 2014

4 Statutory audit services for large companies market investigation – A report on the provision of statutory audit services to large companies in the UK; Competition Commission; October 2013

5 Commission Recommendation on the quality of corporate governance reporting ('comply or explain' principle); 2014/208/EU; April 2014

6 Proposal to amend Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement; European Parliament and of the Council; April 2014

The FRC welcomes the focus in the Shareholder Rights Directive on the long-term investment behaviour of institutional investors and the important role they can play. While we have some concerns about the level of prescription throughout the Directive, we welcome the direction of travel. Recent drafts of the Directive have addressed some of these concerns, but the scope of the Directive is complex and the negotiation process has some way to go.

The Shareholder Rights Directive covers many other aspects of investor and company interaction, including voting on remuneration, the identification of shareholders, related party transactions and proxy voting advisors. The FRC will work closely with BIS as the Directive progresses.

The FRC looks forward to assisting the European Commission and the European Parliament with the development of the Shareholder Rights Directive and other policies from the Communication on Long-Term Financing.[7]

Shareholder voting and confirmation also continue to be of concern for companies and investors. The Shareholder Voting Working Group has been reconstituted to consider the ongoing concerns about the voting chain. We understand that the group is looking to release a paper for consultation early in 2015 to consider the areas where progress may be made.

Review of the OECD's Principles of Corporate Governance

The *OECD Principles of Corporate Governance*[8] is a global public policy instrument intended to assist governments and regulators to evaluate and improve the legal, regulatory and institutional framework for corporate governance. It also provides guidance for stock exchanges, investors, corporations and others that have a role in the process of developing good corporate governance. The objective of the Principles is to contribute to economic efficiency, sustainable growth and financial stability. The Principles are part of the key standards for sound financial systems of the Financial Stability Board and the basis for the corporate governance component of the World Bank's Reports on the Observance of Standards and Codes.

An updated version of the 2004 Principles was issued for public consultation in November 2014, with a revised set of principles to be published later in 2015.

Kay Review Progress Report

Building a Culture of Long-Term Equity Investment – Implementation of the Kay Review: Progress Report was published in October 2014.[9] The FRC welcomes the Government's undertaking to consult on changes to the investment regulations to require trustees of trust-based pension schemes to state the scheme's policy (if any) on stewardship in the scheme's Statement of Investment Principles, with reference to the UK Stewardship Code. The FRC sees asset owners as key to driving stewardship through the investment chain. In encouraging a consideration of stewardship, the FRC welcomes recent changes to The Pensions Regulator's Trustee Toolkit, which outlines the way in which trustees may wish to take account of both the UK Corporate Governance and UK Stewardship Codes when considering their approach to investment and corporate engagement.

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7 Communication on long term financing of the European economy; European Commission; March 2013
8 OECD Principles of Corporate Governance; Organisation for Economic Co-operation & Development; 2004
9 Building a Culture of Long-Term Equity Investment – Implementation of the Kay Review: Progress Report'; BIS; October 2014

The Report also noted the launch of the Investor Forum in July 2014, a key recommendation of the Kay Review. The Forum is working with market participants to consider the best way for it to approach its role. The FRC looks forward to helping the Forum with its work assisting investors better to engage with the companies in which they invest.

Other initiatives announced in the Report include setting up a taskforce to consider the *Metrics and models used to assess company and investment performance* research paper[10] and the holding of a roundtable with senior stakeholders from business and the investment industry, to be hosted by the Secretary of State. The FRC looks forward to working with BIS to consider the state of stewardship and the recommendations addressed to the FRC.

The Law Commission

The Law Commission released its report *Fiduciary Duties of Investment Intermediaries* in July 2014.[11] The Government's response to this was outlined in its Kay Review Progress Report.

The Law Commission was asked by BIS, following a recommendation of the Kay Review, to consider the law of fiduciary duties. This report also considered the investment chain; the roles of different market participants; stewardship; and the investments of pension funds. The report did not recommend defining fiduciary duties in statute. Instead, to counter the criticism from many consultees that the law was insufficiently certain, the Commission highlighted instances in which more guidance may be appropriate. While focusing on fiduciary duties the report also echoed the Kay Review concerns around uncertainty; the length of the investment chain; and the effect of intermediation on ownership.

The Law Commission's *Fiduciary Duties for Investment Intermediaries: Guidance for Pension Trustees* was also released in July 2014.[12] Addressed to pension trustees, the guidance makes clear that asset owners should take account of any investment factors they consider to be material to performance. The guidance should assist to dispel the narrow view that pension trustees must focus solely on strict 'investment' returns. The FRC encourages asset owners to review this guidance and how it might affect their approach to investment and the consideration of environmental, social and governance issues.

[10] BIS research paper 190: Metrics and models used to assess company and investment performance; BIS; October 2014

[11] Fiduciary Duties of Investment Intermediaries; Law Commission; July 2014

[12] Fiduciary Duties for Investment Intermediaries: Guidance for Pension Trustees; Law Commission; July 2014

Governance of Listed Companies

This section of the report sets out how the UK Corporate Governance Code has been implemented during 2014 as well as providing an assessment of the quality of reporting on corporate governance. There is a focus on the principles and provisions introduced in 2012.

Overall, the rates of compliance with the Code continue to be very high among companies of all sizes. While reporting remains good, examples still persist of generic and boiler-plate disclosures. Mid- and small-cap companies may lack the resources available to larger firms, but all companies should be capable of explaining clearly how they are governed, including (where applicable) why they have departed from compliance with the Code.

Overall compliance rates

The annual survey of compliance by FTSE 350 companies carried out by Grant Thornton[13] found that 94 per cent of companies complied with all, or all but one or two, of the Code's 54 provisions, while 61 per cent reported full compliance with the Code, an increase of 4 per cent on 2013.

Code provision B.1.2 remains the lowest rated in terms of compliance among FTSE 350 companies. This states that at least half the board, excluding the chairman, should be independent. The rate of compliance has risen from 87 per cent to 90 per cent since the last report in December 2013. The FRC's assessment of the quality of the explanations given for non-compliance with this provision is discussed below.

Data compiled by Manifest[14] on behalf of the FRC shows that, in respect of board and committee composition, compliance levels among companies on the FTSE Small Cap and Fledgling indices are generally consistent with those of larger companies. As seen in the table below the figures are similar to those reported in December 2013.

Table: Compliance with selected provisions of the UK Corporate Governance Code

Code requirement	FTSE 350 companies		Smaller companies	
	2014	2013	2014	2013
Separate Chairman and CEO	96%	94%	99%	97%
Met minimum provisions for number of independent NEDs	90%	87%	99%	99%
Met minimum provisions for audit committee composition	92%	94%	93%	96%
Met minimum provisions for remuneration committee composition	91%	92%	89%	84%
Met minimum provisions for nomination committee composition	96%	96%	99%	98%

Sources: Grant Thornton and Manifest

Note: There are different requirements for FTSE 350 and smaller companies regarding the minimum number of independent directors and the minimum requirements for board and committee composition (for example, for FTSE 350 companies independent directors should make up at least half the board, while smaller companies are only expected to have at least two independent directors).

13 Plotting a new course to improved governance; Grant Thornton; December 2014
14 Manifest looked at a sample of 276 companies, 259 on the Small Cap Index and 17 on the Fledgling Index.

Board composition and evaluation

Following the introduction in 2010 of Code provision B.6.2, that board evaluation of FTSE 350 companies should be externally facilitated at least every three years, Grant Thornton reported for 2014 that nearly 40 per cent of companies carried out such a review.[15] This builds on their research findings over the first three years of this new provision that 34 per cent in 2013, 35 per cent in 2012 and 25 per cent in 2011 reported that they had carried out an externally facilitated board review. These figures should be viewed with some caution as they will include a number of companies that have carried out more than one externally facilitated review in that period. Overall, though, it is a positive response to this provision.

The change to the Code in 2012 recommending that companies disclose the identity of the external facilitator and whether they had any other link to the company has been reported on by all the companies which carried out an external review this year. Of these, 91 companies stated whether there was any other connection with the company.[16] A wide range of providers operate in this arena, with 38 different facilitators named (a decrease from 51 in 2013). However, 43 of the evaluations were carried out by just three firms.[17] As noted in last year's report, the 2010 Code change undoubtedly prompted more providers to enter the market, so the decline may indicate that the market is beginning to resolve earlier concerns about the quality of the service provided.

Succession planning and the appointment process

The FRC's project on succession planning is aimed at identifying and increasing good practice and, more specifically, at how the nomination committee can play its role effectively. Unless boards are planning over the medium- to long-term, for both executive and non-executive positions, they will struggle to ensure that there is the right mix of skills and experience needed as the company evolves. A series of meetings have been held with key stakeholders. The intention is to publish a discussion paper in the Spring which will include our preliminary findings, and request views on these.

Research carried out by Cranfield[18] for their Women on Boards report on behalf of the FRC and the Government Equalities Office also looked at what companies said about succession planning to see if this supported the evidence from board effectiveness reviews that it was an area for improvement.

As with last year's review, Cranfield found that there was little consistency in what was reported, with many companies still only talking about succession planning in terms of replacing individual board directors. 'This is really a retrospective response and does not address the more strategic issue of longer term succession planning, including the development of executive strength within the organisation. Transparency around the appointment process forms part of good corporate governance reporting... However, this should not replace reporting on forward thinking succession planning.'[19] Alongside this need to improve reporting, Grant Thornton found that nomination committee reports included a chairman's introduction in 35 per cent of reports (31 per cent in the previous year).[20]

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15 Plotting a new course to improved governance; Grant Thornton; December 2014
16 Annual Reporting and AGMs 2014: What's Market Practice?; Practical Law; November 2014
17 Plotting a new course to improved governance; Grant Thornton; December 2014
18 Women on Boards: Progress following the 2012 Corporate Governance Code; Cranfield University School of Management; October 2014
19 Women on Boards: Progress following the 2012 Corporate Governance Code; Cranfield University School of Management; October 2014
20 Plotting a new course to improved governance; Grant Thornton; December 2014

Diversity

The headline figure for female directorships in FTSE 100 companies is up from 18.9 to 22.8 per cent when combining executive and non-executive directorships. This means that Lord Davies' target of 25 per cent female directorships in 2015 is well within reach.

Over the last 12 months there has been a significant increase in the percentage of female executive directors in FTSE 100 companies. This is now at 8.4 per cent, after stagnating for many years at 5–6 per cent. The FTSE 250 has seen a marginal decrease from 5.3 to 5.1 per cent, while smaller listed companies dropped from 5.4 to 4.2 per cent.[21]

There has been an encouraging improvement in the number of non-executive director positions with the percentage of FTSE 100 female NEDs rising from 23.9 to 27.9 per cent over the year. Similar increases have been seen in FTSE 250 and Small Cap companies, where women now account for 22.1 and 15.9 per cent of non-executive roles respectively.

Cranfield reported that women accounted for 32 per cent of new director appointments in FTSE 100 companies in the six months to September 2014, and 24 per cent in FTSE 250 companies. In the equivalent period in 2013, it was 27 and 29 per cent respectively.

Gender is, of course, just one aspect of diversity which boards should consider. The preface to the 2014 Code now says that race, experience and approach are also important when determining the appropriate balance of skills and attributes that are needed. This balance is key to ensuring effective stakeholder engagement and to delivering the business strategy.

The 2012 edition of the Code brought in the expectation that listed companies should set out in their annual reports their policy on boardroom diversity and that they should report on progress against any measurable objectives they have set themselves. Cranfield's research (see table below) found that 98 per cent of FTSE 100 companies now make some reference to boardroom diversity, and that 85 per cent of them had what Cranfield considered to be a clear policy on the subject. Other research on FTSE 350 companies found similar results.[22]

The results for the FTSE 101–201 companies showed that while 97 per cent referred to diversity, only 56 per cent set out a clear policy. Although this is consistent with what the FRC has seen in relation to the implementation of other Code changes, it remains an area where more improvement is required.

Table: Disclosure of diversity policies

	FTSE 100 companies	**FTSE 101–201 companies**
Does the report directly address or refer to the FRC Code?	98%	97%
Does the company have a clear policy on boardroom diversity?	85%	56%
Does the policy specifically mention gender?	78%	55%
Does the company set measurable objectives?	58%	25%
Does the company record progress against those objectives?	52%	25%

Source: Women on Boards: Progress following the 2012 Corporate Governance Code; Cranfield University School of Management; October 2014. Data based on the annual reports of FTSE 350 companies issued between October 2013 and September 2014.

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21 All data on gender diversity on the boards of FTSE 350 companies in this section is taken from Women on Boards: Progress following the 2012 Corporate Governance Code; Cranfield University School of Management; October 2014. Data on smaller listed companies was provided by Manifest.

22 Grant Thornton found that 94 per cent of FTSE 350 companies provided at least some description of the company's boardroom diversity policies.

Audit committee reporting

The 2012 changes to the Code introduced requirements for audit committees to provide more detail on the work they do. This should include: descriptions of the significant issues considered by the audit committee in relation to the financial statements and how they were addressed; how the audit committee assessed the effectiveness of the external audit process; and their approach to appointing the auditor and safeguarding objectivity and independence relative to the use of non-audit services. In parallel, changes were introduced in the auditing standards to require auditors to provide extended reports that discuss audit risks, materiality and audit scope. We will be issuing a separate report on the implementation of these changes to auditor reporting.

It is encouraging to see that approximately two-thirds of audit committees now provide a good or detailed discussion of significant accounting issues. Grant Thornton found that 'most reports give an informative description of the work undertaken; the best distinguish themselves by providing effective context to each issue and its relevance to the company.'[23] The Financial Reporting Lab's *Reporting of Audit Committees* paper[24] (which provided insights from companies and investors on effective approaches to audit committee reporting) noted that investors value a clear description of the context of each issue; the actions taken by the audit committee; and the conclusion or outcome. An FRC sample of 10 per cent of FTSE 350 audit committee reports produced similar findings, with a third of the sample rated as needing to give better disclosures of significant issues.

The FRC has recognised the difficulties faced by audit committees in relation to the assessment of the effectiveness of the external audit process and is producing guidance to assist audit committees in discharging and reporting on this duty.

Disclosure in relation to appointing the auditor, safeguarding objectivity and independence relative to the use of non-audit services has generally been of a good standard, although improvement around the expected timing of an audit tender is still needed.

Grant Thornton also reported that, for the first time, more than half of audit committee reports included a chairman's introduction (55.8 per cent compared to 44 per cent in 2013).

As part of our review of the implementation of the auditor reporting changes, we also surveyed how well the descriptions of significant issues provided by audit committees complemented the descriptions of the equivalent risks in the extended auditor's report. We found that approximately 90 per cent of audit committee reports complemented the auditor's report well. However, we also found that in the majority of cases the auditor's report appeared to be more informative than the report of the audit committee with respect to significant issues.

Audit tendering

The Code revision in 2012 added a recommendation that FTSE 350 companies should put their external audit contract out to tender at least every ten years. Transitional arrangements were also provided as it was not expected that all companies who had not undertaken a tendering exercise in the previous ten years would do so within the first year of applying the revised Code.

[23] Plotting a new course to improved governance; Grant Thornton; December 2014
[24] Reporting of Audit Committees; Financial Reporting Council; October 2013

27 FTSE 350 companies reported in their 2013–14 annual report that they had carried out an audit tender, with 19 of those companies changing auditors as a result.[25] From the Financial Reporting Lab's informal discussions with investors on this matter it is clear that specific information regarding the timeline of past and future tendering, in addition to the name and tenure of both the audit firm and partner, is useful information to disclose.

BIS published in December 2014 a consultation on the new EU Audit Directive which requires all public interest entities to put their audits out to tender every ten years and rotate auditors after 20 years. The Competition and Markets Authority has also made an Order requiring FTSE 350 companies to put their audits out to tender every ten years. As already noted we will consider whether to retain the 'comply or explain' tendering provision in the Code in light of these developments as part of the Code's 2016 review.

Explanations

As already noted, only a small number of companies depart from the Code. However, it is important that, where companies do not follow a Code provision, a clear explanation is provided so that their shareholders can assess whether they are content with the governance arrangements that the company has put in place.

The Code sets out in the chapter on 'comply or explain' a number of features of meaningful explanations, to provide a benchmark for companies when providing explanations and shareholders when assessing them. These are: that the explanation should set out the background, provide a clear rationale for the action being taken, and describe any mitigating activities. Also, where deviation from a particular provision is intended to be limited in time, the explanation should indicate when the company expects to conform with the provision.

The FRC has again reviewed a selection of explanations in FTSE 350 annual reports published in 2014 to assess the extent to which companies are providing this information. The review looked at two areas of non-compliance: where the roles of the chairman and chief executive have been combined (Code Provision A.2.1) and where less than half the board of a company, excluding the chairman, comprises of independent non-executive directors (Code Provision B.1.2). The latter remains the provision with the most frequent explanation of non-compliance.

The standard of explanations continues to be variable. While the majority of examples reviewed provided at least some of the information the FRC expects, there are still a number of cases where the company simply asserted that the governance arrangements it had adopted were appropriate for its circumstances.

It continues to be the case that companies seem to find it easier to explain what their actual governance arrangements are and, where relevant, the actions intended to make the company compliant with the Code, rather than to explain why they consider those arrangements to be the most appropriate for the company.

In the first half of 2015 the FRC will be communicating further on 'comply or explain' to remind both companies and investors that simply complying without giving due consideration to what is appropriate and relevant reduces the flexibility that this approach aims to achieve.

[25] Annual Reporting and AGMs 2014: What's Market Practice?; Practical Law; November 2014

Explanations where companies have a combined chairman and CEO (A.2.1)

There were 10 companies in the FTSE 350 who had one individual as both Chairman and CEO in 2014. In six cases this was a temporary arrangement, and the majority arose when one of the roles became vacant sooner than expected. An effective example of disclosure was provided by a company which explained that the succession of the internal candidate for CEO was fast-tracked once the serious illness of the incumbent came to light.

In the four companies where the combination of the two roles was open-ended (i.e. no time limit was mentioned in their explanations) the majority of cases offered no obvious rationale or mitigating arrangements, possibly as some were long-standing situations. One exception to this was a company which set out in detail the background to why the roles had been combined in 2011 and what mitigations had been taken – this included the Deputy Chairman being responsible for overseeing board effectiveness and being empowered to engage directly with shareholders.

Overall explanations in relation to non-compliance with the provision (A.2.1) were of poorer quality than last year, with little real information provided in a number of cases. There was also no mention of whether the company's larger shareholders had been consulted. Dialogue with shareholders is to be encouraged, and it would be sensible to then set out in the annual report the reasons given to them.

Explanations where less than half the board, excluding the chairman, comprises independent non-executive directors (B.1.2)

Of the 26 FTSE 350 companies non-compliant with this provision fewer than half had returned to having more than 50 per cent of the board as independent non-executive directors at the time their annual report and accounts was published. A mix of reasons was given for this. Often there was little more than a general statement about the need to avoid the board becoming too large and unwieldy. Some pointed to the need for a balance of skills and experience on the board. However, one company did detail what it was doing:

> The company has, however, made significant strides over the past few years to bring its board structure more in line with best practice. In particular, the number of executive directors has been reduced to eight, compared to 14 in 2009, and two new independent directors were appointed at the beginning of the year. It is the company's intention over time to get to a position where the majority of its board comprises non-executive directors, even if not all are independent because of their relationship with [connected shareholder].

Overall we believe it is helpful to investors if companies provide information on why they believe the composition of the board is appropriate, bearing in mind that the Code asks that companies explain what mitigating actions the board has put in place to ensure a sufficient degree of independence is maintained. This is particularly important in cases where a departure from the Code is expected to be permanent.

Explanations continue to be clearer where companies depart from the Code due to force of circumstances – such as directors leaving the board at short notice. There were also a number of newly listed companies who were still moving towards compliance with the Code's reporting requirements. The fact that a number of the companies in the former set of circumstances returned to compliance during the course of the year or were taking action to do so, suggests that poor succession planning may be a contributing factor rather than a fundamental disagreement with the Code.

Election of directors

Provisions B.7.1 and B.7.2 of the Code detail the information that should accompany the resolutions for the election of directors. This includes biographical detail, confirmation from the chairman that the individual's performance continues to be effective and, in the case of non-executive directors, the reason why the company believes the individual should be elected.

The FRC has again reviewed a sample of 50 annual general meeting notice papers from a cross-section of listed companies, including those outside the FTSE 350, to assess the extent to which companies were following these recommendations. As with the 2013 sample the results were mixed.

A significant number of companies gave no detail other than the name of the directors, leaving shareholders to cross-check biographies in the annual report. However, the large majority of AGM notices did include references to both how directors were performing and information on the individual, although this tended to be basic biographical information only.

There were some notable examples of companies setting out clearly the specific contribution that the individual brought to the board, in terms of their particular skills and strengths, but these were still the minority. One company laid out the information under the following headings – skills and experience, independence, other current principal external appointments and committee membership – which was considered a useful format. Another added in headings covering responsibilities, qualifications and career experience. Specific best practice examples included: 'XX's financial experience provides knowledge and expertise to guide the company in the future' and 'XX's experience of customer facing businesses, together with her knowledge of operating within a regulated environment, will be major assets to the board...'. Explaining how individual directors contribute to the effectiveness of the board as a whole is helpful to investors since it provides for better informed voting decisions.

'Fair, balanced and understandable'

Following the 2012 update to the Code, boards were asked to confirm that the company's annual report and accounts taken as a whole was fair, balanced and understandable. One desired outcome is that the narrative sections of the report are a more accurate reflection of the company's position, performance and prospects.[26]

The Grant Thornton review of all FTSE 350 annual reports highlighted that in terms of the nature of the assessment 'approaches seem to range from substantive testing of narrative and non-statutory information, to a "sense checking" of disclosures and the balance of the narrative against the information reported to the board during the year.'[27] A quarter of companies provided good or detailed commentary, whereas two-thirds gave little or no justification to support their fair, balanced and understandable assertion. It is of concern that nearly 10 per cent of companies made no comment at all.

The FRC sampled 10 per cent of FTSE 350 annual reports and found that the audit committee report was the most frequent place to comment on the assessment, although other references were also found in the statement of the directors' responsibilities, while a small number of Chairman's reports were found to include this matter.

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[26] The FRC's Financial Reporting Lab's August publication *Towards Clear & Concise Reporting* provides an illustration of how legal requirements and the UK Corporate Governance Code interact in Appendix 3. This includes how fair, balanced and understandable relates to other reporting requirements.

[27] Plotting a new course to improved governance; Grant Thornton; December 2014

Risk management

The FRC's Corporate Reporting Review team noted, in its 2014 annual report, that there had been continued 'improvements in the disclosure of companies' principal risks and uncertainties, following our earlier focus on this area of narrative reporting. We are pleased that an increasing number of companies now explain how they manage or mitigate the risks identified, but we still identify companies that do not.'[28] The report goes on to say that the team will continue to write to those companies who present a long list of possible risks without highlighting those believed to be the most important.

The FRC published new risk guidance[29] in September 2014, which was an amalgamation of the 2005 Turnbull (internal control) and 2009 Going Concern guidance notes revised to reflect the finalised requirements of the 2014 Code. This also took account of the comments from earlier consultations in November 2013 and April 2014. The Code changes included:

- Companies should state whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so;

- Companies should robustly assess their principal risks and explain how they are being managed or mitigated;

- Companies should state whether they believe they will be able to continue in operation and meet their liabilities taking account of their current position and principal risks, and specify the period covered by this statement and why they consider it appropriate. It is expected that the period assessed will be significantly longer than 12 months; and

- Companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.

These changes apply to financial years beginning on or after 1 October 2014, therefore we will assess the quality of reporting by early adopters in our next report. Deloitte reviewed a sample of FTSE 350 annual reports and found that 64 per cent of companies were already giving sufficient detail on the descriptions of their principal risks and uncertainties.[30] It was noted that only a small minority (6 per cent of the sample) explain their principal risks by providing information on the likelihood of the risk occurring and its potential impact on the business if it did.

In terms of the quality of current going concern disclosures, the Deloitte review found 69 per cent of companies surveyed had a specific statement with clear cross-referencing to other relevant information. There were still some companies who had no cross-referencing or a bland uninformative statement (17 and 13 per cent respectively). Very few companies, Deloitte found just four, gave any detail on longer term viability – clearly this area should see an increase in more explicit reporting as a result of the 2014 Code changes.

[28] Corporate Reporting Review Annual Report 2014; Financial Reporting Council; October 2014
[29] Guidance on Risk Management and Internal Control and Related Financial and Business Reporting; Financial Reporting Council; September 2014
[30] The data on risk and going concern is from Annual Report Insight 2014 – Providing a clear steer; Deloitte; October 2014

Remuneration

2014 saw the implementation of the Government's new disclosure and voting requirements for directors' remuneration, including a binding vote on a company's remuneration policy for directors. There was one well documented case of a company failing to gain shareholder approval for the remuneration policy. The Deloitte report found that 79 per cent of companies in the FTSE 100 received more than 90 per cent of votes in favour of their annual remuneration report, with 83 per cent having over 90 per cent in favour of the policy report. For FTSE 250 companies the figures were 82 and 85 per cent respectively.[31] 52 companies in the FTSE 350 received a vote ranging between 10 and 49.9 per cent against the remuneration report.[32]

The 2014 revisions to the Code included changing:

- Main Principle D.1 so that it refers to the design of remuneration to promote the long-term success of the company; and

- Provision D.1.1 to recommend that provisions are put in place to recover and/or withhold remuneration when appropriate.

Deloitte reported that for the FTSE 100 and FTSE 250 90 per cent and just over 80 per cent respectively already had some form of these provisions in place. It added that provisions enabling recovery of sums already paid are in place in over 40 per cent of FTSE 100 companies. This figure is approximately 30 per cent for the FTSE 250.[33]

Other voting

The 2014 Code introduces a requirement, under provision E.2.2, in relation to companies explaining, when publishing meeting results, how they intend to engage with shareholders when a significant percentage of them have voted against any resolution. The FRC's intention is to change behaviour so that companies explain how they intend to engage with shareholders in order to assess their concerns (rather than setting-out how they intend to respond to those concerns). The FRC continues to expect that engagement by investors ahead of the meeting remains a key requirement of good stewardship.

The table below shows the outcomes on other categories of resolutions at AGMs held in 2014, aside from remuneration, with significant shareholder opposition. We will look in more detail at what companies do in response once the 2014 Code changes start to take effect.

Table: Significant Minority Voting at AGMs

Resolution Type	Number of resolutions voted against by 20% or more of shareholders	Number defeated
Audit & Reporting	2	–
Corporate Actions	1	–
Director elections	16	–
Issue of shares & pre-emption rights	12	2
Shareholder Rights	7	2

Source: Manifest

31 Your Guide – Directors' remuneration in FTSE 100 and 250 companies; Deloitte; September 2014
32 Annual Reporting and AGMs 2014: What's Market Practice?; Practical Law; November 2014
33 Your Guide – Directors' remuneration in FTSE 100 and 250 companies; Deloitte; September 2014

Stewardship and Engagement

Introduction

The UK Stewardship Code is now four years old, with almost 300 organisations publicly registered as signatories, comprising 201 asset managers, 81 asset owners and 13 service providers. Asset manager and asset owner respondents to the latest Investment Management Association (IMA) survey of the Code held £708 billion and £38 billion of UK equities respectively.[34] The asset manager respondents represent 32 per cent of the UK equity market; an amount the FRC considers is a significant proportion of the market and a core group capable of undertaking meaningful stewardship activities.

The Code was developed to achieve a number of objectives: to help build a critical mass of investors that are willing and able to engage with the companies in which they invest; to increase the quantity and quality of engagement; and to increase accountability down the investment chain to clients and beneficiaries.

The trends on these key objectives are going in the right direction. There are encouraging signs that more engagement on a wider range of issues is taking place between large companies and their major shareholders, but this is not the case across the listed sector or all signatories. In relation to quality, we have heard from both companies and investors that more proactive and better quality engagement between them, especially in the context of the new binding vote on remuneration, is required. The FRC is anxious to ensure that this proactive engagement is quality engagement. Reporting from some signatories continues to improve but most signatories to the Code would benefit from considering ways in which they can be more accountable to their clients and beneficiaries and fully explain their approach to stewardship.

The FRC acknowledges that the development of a culture of stewardship may take time. However, the FRC is concerned that not all signatories are following through on their commitment to the Code. Although some signatories have shown progress in their statements and reporting on their stewardship activities, this does not apply to the large majority of signatories. The main focus for 2015 and 2016 is to improve implementation of the Code. The areas of focus include: developing the evidence base for the benefits of stewardship; generating demand from asset owners for stewardship work by fund managers; and undertaking greater scrutiny of adherence to the Code.

Quality of engagement

As expected, remuneration was the biggest topic of engagement in 2014. Both companies and investors reported more proactive engagement on this topic in light of the new binding vote on the directors' remuneration policy. We encourage this greater proactive engagement, but understand the frustration of both companies and investors that the focus on remuneration can crowd out other issues. A recent report by Institutional Shareholder Services UK found that board nominations and remuneration proposals now account for more than 40 per cent of all resolutions voted on by shareholders.[35] The IMA survey showed that board remuneration was the main issue for engagement; although, it was considered only the fourth most important issue, after strategy and objectives; board leadership; and board and committee composition/succession. Many companies have told us that they would welcome more engagement from investors on other substantive issues.

[34] Adherence to the FRC's Stewardship Code: At 30 September 2013; IMA; June 2014
[35] ISS European Voting Results Report

There were some significant votes against resolutions in 2014, as discussed in the previous section. While a high level of votes against may be an indicator of ineffective engagement by either party, it can also be an indicator that shareholders feel empowered to question and hold companies to account.

On the issue of the quality of engagement, a number of participants in a survey organised by the GC100 (the association for the general counsel and company secretaries of companies in the FTSE 100) noted that, on the whole, investors are informed and inquisitive and are generally asking the right type of questions to generate a high quality of debate.

In an annual survey of its issuer members the Investor Relations Society has found that investors this year are seeking much greater engagement with Chairmen/non-executives and senior management. Corporate issuer members also reported an increase in face-to-face investor meetings and one-to-one calls/online investor meetings in the last year. While the FRC encourages this increase in meetings and engagement, we note that collective engagement processes have not yet developed; with more than 60 per cent of the Investor Relations Society issuer members surveyed reporting no change in group conference calls/online meetings or other physical group meetings. The FRC acknowledges that resources may constrain the activities of both investors and companies but encourages a greater use of collective engagement.

The FRC considers asset owners as key in driving stewardship and there are some encouraging signs. The IMA survey showed that the proportion of asset managers where 'all' or 'some' mandates refer to stewardship increased to 83 per cent from 71 per cent in 2012 and from 65 per cent in 2011. In particular, for 44 per cent of asset managers stewardship is referred to in the mandates of all their clients – as compared to 30 per cent in 2012 and 29 per cent in 2011.[36] The National Association of Pension Funds (NAPF) Engagement Survey mirrored these conclusions, with 80 per cent of respondents taking stewardship into account when selecting managers, including 60 per cent of respondents actively questioning prospective managers about their approach.[37] Unfortunately, only a little over half translate this into explicit expectations in mandates.

Asset owners are able to drive a demand for stewardship through the investment chain by requesting it of their providers. The NAPF survey[38] found that just 53 per cent of respondents felt that institutional investors had played a sufficiently active role as stewards of investee companies over the past year. The influence and actions of asset owners will be a key focus for the FRC in 2015.

Although the Code is underpinned by a UK regulatory regime and applies in the first instance to equity holdings, many signatories go beyond the minimum recommendations when engaging with companies. For example, engagement in asset classes other than equity has increased, particularly for fixed income and other types of holdings such as hedge funds and commodities.[39] The IMA survey also found a large increase in engagement with holdings outside the UK. In 2013, a smaller proportion of respondents did not engage with any companies where their equity holdings are listed outside the UK – 6 per cent relative to 11 per cent in 2012.[40] At the same time, there was an increase in those that engaged in

36 Adherence to the FRC's Stewardship Code: At 30 September 2013; IMA; June 2014

37 NAPF Engagement Survey: pension funds' engagement with investee companies; NAPF; November 2014

38 NAPF Engagement Survey: pension funds' engagement with investee companies; NAPF; November 2014

39 The IMA survey found that the most notable change was the increase in the proportion of respondents that engage with fixed income investments at 41 per cent from 36 per cent in 2012. There has also been an increase (from 6 per cent to 13 per cent) in the proportion of respondents that engaged with 'other' asset classes, such as hedge funds, infrastructure, commodities and deposit funds.

40 Adherence to the FRC's Stewardship Code: At 30 September 2013; IMA; June 2014

emerging markets – a trend mirrored in the NAPF survey, in which pension funds reported an increase in their exercise of votes from 59 per cent to 85 per cent in emerging markets.[41]

The issue of corporate governance integration with the mainstream investment decision-making process continues to concern companies. The IMA survey showed that, where corporate governance specialists are involved, almost 90 per cent of respondents have formal integration arrangements and the involvement of portfolio managers in controversial voting decisions is increasing.[42] However, while GC100 survey respondents noted some areas of good practice, they also highlighted concerns with the low level of integration of corporate governance teams. The issue of clear communication from investors is an important one, as trust between investors and companies can otherwise be needlessly eroded. We encourage investors to consider the clarity of their statements on voting decision-making processes and the involvement of portfolio managers.

The approach to stewardship is still very manager-specific. Despite room for improvement, the latest NAPF survey showed an increase in the level of satisfaction with the standard of stewardship reporting from asset managers, possibly driven by asset owners requesting more tailored and integrated reporting. These asset owners also indicated that they were spending more time reviewing reporting from their providers, and 54 per cent of them asked more stewardship questions during reviews.[43] In this context, it is disappointing to see that the level of satisfaction with the reporting from investment consultants on the actions of asset managers remains largely unchanged.

Even more disappointing is the statistic that 41 per cent of the NAPF survey respondents' investment consultants had not raised the topic of stewardship with them.[44] This is especially the case as each of the respondents to the NAPF survey have over £1 billion in assets under management and all of the major investment consultants are signatories to the Code.

The NAPF continues to promote the benefits of stewardship to its members and to assist them to understand the approach of those undertaking stewardship activities on their behalf. In late October 2013 the NAPF launched the Stewardship Disclosure Framework, with the aim of encouraging greater transparency by asset managers around their stewardship responsibilities. As at 30 November 2014, 64 asset managers had provided public responses to the Disclosure Framework. We encourage asset managers to disclose against the framework in order to explain their approach to stewardship and asset owners to question their managers about aspects of their approach and why they have not provided public responses against the NAPF framework.

In order better to assist the transparency of asset manager activities on stewardship, the NAPF launched Stewardship Accountability Forums in November 2014. These forums give pension funds the opportunity to hear from senior representatives of asset managers about their organisation's approach to stewardship. This allows asset owners better to understand, compare and contrast the approaches available to them. The FRC supports initiatives such as these which encourage a flow of information and build accountability through the investment chain.

41 NAPF Engagement Survey: pension funds' engagement with investee companies; NAPF; November 2014
42 Adherence to the FRC's Stewardship Code: At 30 September 2013; IMA; June 2014
43 NAPF Engagement Survey: pension funds' engagement with investee companies; NAPF; November 2014
44 NAPF Engagement Survey: pension funds' engagement with investee companies; NAPF; November 2014

Quality of statements

The FRC monitors a sample of signatories' statements against the Code every year. The 2014 monitoring sample covered 50 signatories chosen at random across all three categories – asset manager, asset owner and service provider.

For the FRC, the main concern remains the quality of reporting against the seven principles of the Code (see table below). One of the main objectives of the Code is to build transparency of approach through the investment chain, which can only be achieved through sufficient and effective reporting to clients and beneficiaries. Analysis of the statements made by all signatories found that not all are reporting against all seven principles of the Code. For those who do report against all the principles the depth of statements continues to vary considerably.

It is the FRC's expectation that signatories will make a statement that describes how they apply each of the seven principles of the Code and disclose the specific information requested in the guidance to the principle; or, if one of the principles has not been applied or disclosures have not been made, explain why the signatory has not complied with those elements of the Code. While the quality of disclosure across the seven principles is important, the FRC is also concerned about explanations when provisions of the Code have not been followed. The Code aims to assist clients to understand the approach taken by those making investment decisions on their behalf and achieve transparency without prescription. The narrative around an explanation allows a client to understand the approach of an asset manager and a company to understand the approach of its investors. If thoughtful and insightful explanations are not utilised, the 'comply or explain' system fails to achieve transparency. The FRC will look to signatories to make better efforts to report sufficiently across the seven principles and the instances where explanations are required.

	Principle	Comments
1	**Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**	• Some signatories report effectively on their approach to active ownership and role within the investment chain. • Weaknesses include reporting on the integration of stewardship within the wider investment process and a discussion of outsourced activities and compatibility with the signatory's approach. • Very few discuss how their approach to stewardship enhances and protects the value for the ultimate client or beneficiary. • Although the benefits of stewardship can be difficult to quantify, this does not preclude signatories from explaining why they take a particular approach. • When properly reported against, Principle One can lead to great insight for clients and beneficiaries and encourage a better understanding and dialogue with those in whose name the funds are invested.

	Principle	Comments
2	**Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.**	• Disclosures need to address the priority given to client interests in decision-making. Reporting on this is a point of particular weakness. • Consideration should be given to the likely range of conflicts and to publicly disclosing the policy for identifying and managing such conflicts. • Many asset owner signatories' statements in our sample delegated the day-to-day management of stewardship activities to managers and did not assess wider conflicts of interest.
3	**Institutional investors should monitor their investee companies.**	• Reporting on this principle is generally stronger than against the other principles. Most of the signatories in the sample gave a basic overview of the issues taken into account when considering and monitoring investments and discussed their approach to information-gathering. • Reporting on the issue of becoming an insider is not sufficient and, in some cases, is overlooked entirely.
4	**Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.**	• There is some information on the internal approaches to escalation of stewardship activities. Others only make broad statements that there is an internal system. • Signatories are encouraged to build the picture of their approach to stewardship, especially by reporting more effectively on the way in which they handle escalation.
5	**Institutional investors should be willing to act collectively with other investors where appropriate.**	• Reporting on collective engagement also continues to be of concern. • A number of signatories state their general support for collective engagement and membership of particular bodies but go no further. • Each engagement is based on a set of unique circumstances, but this principle requires an indication when participation in collective engagement would be considered.
6	**Institutional investors should have a clear policy on voting and disclosure of voting activity.**	• Some signatories provided useful insight into their approach to advisors, who they used and the way in which they utilised the relevant information, but most did not provide insightful information on this topic. • Companies still note instances of inadequate communication. It is the responsibility of signatories to make clear the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by proxy advisers.

	Principle	Comments
		• Companies continue to highlight proxy advisors as a point of concern, but claims of 'unthinking voting' are not always borne out by findings. • The FRC encourages investors to make clear the ways in which they use proxy voting advisors, as required by the Code, and also encourages proxy advisors to be open and transparent about their approach.
7	**Institutional investors should report periodically on their stewardship and voting activities.**	• The level and depth of reporting remains uneven. • A number attempt to keep their clients apprised of their work and activities, but we also hear reports of dissatisfaction with the reporting of managers. • As engagement is often carried out on a private basis it can be difficult for those not involved in the process to assess the quality of engagement being undertaken. • It is important that investors focus on making the disclosures they provide in response to the Code as meaningful as possible. • Asset owners should consider the best way to communicate with their ultimate beneficiaries.

The FRC is unable to regulate signatories' processes, but independent assurance can provide some comfort to clients that signatories are following through on their stated practices and we welcome this transparency. Of our monitoring sample, only 24 per cent had gained independent assurance, slightly more than the 17 per cent reported in the IMA survey. A number of other signatories use an internal assurance process, but we encourage signatories to continue to consider independent assurance in order to allow their clients to be assured by the accuracy of the statements and actions being undertaken in their names.

The FRC decided not to amend the Code in 2014 and to focus instead on implementation of the Code and commitment of the signatories to it. The fact that, over two years after the relevant change, a number of signatories, including over 20 per cent of our sample, still have not revised their statements in response to the changes made in 2012 implies that, for some, signing up to the Code is not necessarily a basis for good quality engagement, but is seen as a box-ticking exercise or a necessary hurdle.

The FRC is concerned about the state of commitment to the Code. In 2015, the FRC will undertake greater scrutiny of adherence to the Code. If reporting improvements are not evident, the FRC will develop options to address those signatories which, on an ongoing basis, fail to respond to the concerns we raise with them.

Next Steps

The work of the FRC in the areas of governance and stewardship overlaps with that of many others, and we continue to work closely with regulators, Government departments, market participants, service providers and representative organisations.

The FRC regards the following as key issues for consideration by companies and investors in 2015:

- The importance of good corporate culture and embedding sound governance behaviours throughout companies;
- Board composition and ensuring suitable succession planning is in place;
- Effective board evaluation and reporting;
- Active engagement between boards and investors and improved reporting in this area;
- Early consideration of the new viability statement;
- Maintaining effective risk management and internal controls;
- Focussing on the quality of explanations under both Codes; and
- Committing to clear and concise reporting.

As detailed in other parts of this report, the FRC's corporate governance team will concentrate on five main areas of work in 2015:

Company culture: how best to assess culture and practices and embed good corporate behaviour throughout companies.

'Comply or explain': pursuing better explanations by re-stating the benefits of this approach and encouraging better explanations.

Succession planning: continuing our work and publishing a discussion document in the Spring.

Stewardship Code: promoting the benefits of stewardship and increasing our scrutiny of adherence to the Code in order to improve the quality of practice and reporting.

Proxy advisors: considering what role the FRC might play in overcoming communication problems in this area.

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