

ALAN F PORTER  
GROUP GENERAL COUNSEL AND COMPANY SECRETARY

Catherine Horton  
Financial Reporting Council  
8<sup>th</sup> Floor  
125 London Wall  
London  
EC2Y 5AS

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Dear Ms. Horton

### **Proposed Revisions to the UK Corporate Governance Code**

Prudential plc (Prudential) is a publicly traded company, incorporated in England and Wales, listed in London, Hong Kong, Singapore and New York and a constituent of the FTSE100. Prudential and its affiliated companies (the Group) constitute one of the world's leading financial services groups, providing insurance and financial services around the world. It has been in existence for 169 years and has £635 billion in assets under management (as at 30 June 2017).

We are committed to ensuring the Group operates with high quality corporate governance in the long term interest of our stakeholders. We are open to continuing to strengthen our corporate governance and that of the businesses we invest in, in particular to ensure the interests of all relevant stakeholders are represented as effectively as possible, which we support as a key theme of the FRC's proposals.

As a UK-domiciled company, we expect to be held to high standards and believe our customers, employees and shareholders benefit from these high standards. We are conscious of maintaining the UK's competitiveness as a place of business and the role that the Code can play in this: balancing those high standards of governance with the unique flexibility of the "comply or explain" regime

Thinking more broadly, as a British company with an increasingly global profile, we believe that careful consideration is merited to ensure that new legislation or regulation designed with the UK in mind does not have unforeseen consequences for UK firms' overseas operations.

Prudential welcomes the opportunity to comment on the FRC's proposed revisions to the UK Corporate Governance Code and set out below our feedback, from the perspectives of both a listed FTSE 100 company and a major institutional investor.

We have also worked with the GC100 and the CBI Companies Committee to give input into their submissions to this consultation.

### **Part A: GENERAL COMMENTS**

1. One of our primary goals as an issuer is to ensure that the "comply or explain" principle is upheld in the way the FRC intends it to function, as we believe that it represents the most robust and meaningful approach to governance.



**PRUDENTIAL**

PRUDENTIAL PLC  
12 ARTHUR STREET  
LONDON EC4R 9AQ

TEL 020 7004 4005  
www.prudential.co.uk



It would be helpful if the Code introduction could emphasise further and clarify that compliance with the Code is achieved through a combination of either "apply or explain", making even clearer that either an application of the Code principles or an explanation to stakeholders are equally valid forms of compliance. This could also be reiterated through the Stewardship Code to ensure engagement by investors is expected where a company chooses "explain".

2. We welcome the government's focus on s. 172 of the CA2006 and the disclosure requirements that are expected to be contained in forthcoming secondary legislation.

- a. We request that the FRC ensures that the language of the Code aligns with s. 172 such that directors are not being held to different standards of accountability.

Principle A refers to "*promot[ing] the long-term sustainable success of the company*" which is not aligned with the s. 172 requirement to "*promote the success of the company for the benefit of its members as a whole*" and amongst other things consider "*likely consequences of any decision in the long-term*".

Principle A also refers to a Board "*contribut[ing] to wider society*" which is not a recognised CA2006 concept.

While we recognise that the Code is permitted to impose standards different from legislation, in this important area in which directors can be personally liable for their actions, we think clarity of directors' duties is paramount.

- b. We recognise that requirements for private companies of a significant size to explain compliance with s.172 of the CA2006 will be contained in secondary legislation, rather than the Code. We would ask the FRC to support the case for clear carve-outs for wholly-owned group subsidiaries under a listed parent, where these operate as holding companies within a corporate structure.

3. We suggest that the FRC considers whether any of the disclosures required by the Code or Guidance might be better reported via a company's website, updated on at least an annual basis, rather than in the Annual Report itself, taking into account what might be most useful to stakeholders.

## **Part B: SPECIFIC RESPONSES TO CONSULTATION QUESTIONS**

### **Q1. Do you have any concerns in relation to the proposed Code application date?**

No. We would, however, note that there may be some longer timelines involved in:

- (i) any changes to board composition, in particular Chairs, that might be driven by the new application of independence criteria; and
- (ii) putting in place an appropriate framework to comply with Provision 3.

If the clarification of the regime proposed above to move from "comply or explain" to "apply or explain" was accepted, there does not appear to us to be any requirement for a formal transitional period.

**Q2. Do you have any comments on the revised Guidance?**

- Companies are specifically not required to report on their compliance with the Guidance. However, the language in the introduction to the Code asks that "when reporting on their application of the Code principles, the board should consider how the guidance supports their actions". It would be helpful to clarify if the FRC will in fact use the Guidance as an informal checklist when assessing compliance with the Code.
- **Paragraph 51** of the Guidance sets out that the board may make use of committees to assist its consideration of remuneration, risk, audit and nomination matters but retains responsibility for and makes final decisions on all areas. This is reiterated in **paragraph 96**.

This does not align with our current understanding of delegation to board committees, by which the committee acts as a sub-set of the board and with the correct authority in place through terms of reference may make final decisions on behalf of the company. Does the Guidance intend to change that practice?

- **Paragraph 78** suggests that changes to all NED commitments should be approved by the board as they arise. We suggest this is excessive and in many cases impractical, particularly when early-stage appointments are sensitive. We would suggest that the chairman or nomination committee approve appointments as they arise, with escalation to the board where required (eg, major appointments).

**Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?**

We agree and we support the approach to the workforce voice being captured in principles-based guidance, via the Code to allow companies the option to choose which method best suits their business.

Given the wide variance in corporate structures, business models and workforce populations (at Prudential, for example, we have employees, agency staff and contract staff within our workforce), it is important that organisations have the flexibility to implement practical and effective strategies in a way that best suits them and their stakeholders.

**Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?**

Market practice has centred around 20% being an appropriate threshold for significant dissent. We think it helpful that the revised Code will clarify that this applies across all resolutions and not just remuneration-related resolutions.

In situations where a vote passes on the statutory thresholds (75% for special resolutions and 50% for ordinary resolutions) but still has dissent of 20% or more it will be important to distinguish clearly in text between the statutory regime which is designed to prevent action and the purpose of the 20% dissent register which is to exert shareholder pressure. This may lead to increased explanatory text in AGM circulars and other disclosures.

**Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?**

### *Tenure of Non-executives and Chair*

There is an important balance to be struck between (i) independence and (ii) experience and expertise.

With this balance in mind, we do not agree with the proposed approach in the revised Code that a director cannot be treated as independent if any of the listed criteria apply. While the proposed changes may clarify independence further, we believe that this approach removes board judgement in a critical area.

Recognising the goals that these proposed changes are designed to achieve, we would be supportive of a more nuanced approach around the nine-year time limit for Non-executive Directors who move into the Chair role. This could include allowing independence across a total of 12 years' service or limiting a Chair's tenure to nine years from appointment as Chair.

It appears too prescriptive an approach to merely require a Non-executive Director who goes on to become Chair to count total number of years on the board, when assessing their independence by reference to a nine-year anniversary.

We believe years spent as a Non-executive Director are necessary to prepare an individual for the Chair role and it would be counter-productive to (i) explicitly limit the time an individual could spend in the Chair role having gained NED experience and (ii) rule out non-executive directors who would be suitable for chair appointments due to already having served a number of years.

We would support maintaining the current position making it a judgement for the board as to whether any non-executive director or chair should be considered independent, with the Code providing indicative (rather than mandatory) criteria. The mechanisms for shareholders to challenge in this area, in particular each director's annual re-election at AGM, remain strong.

### *Chair independent on appointment / on an ongoing basis*

We do not think the proposal under the new Code to treat a Chair as independent on an ongoing basis, rather than on appointment, is clear.

Within financial services, Chairs are typically required to have a time commitment close to that of a full-time employee, in order to deal with the heavy demands of the role, in particular meeting with regulators. For example, Prudential's Chair is present in the head office four days a week.

Across all industries, the Chair has a unique position in his relationship with the CEO, as maintained in the Guidance: "*developing productive working relationships with...the chief executive in particular, providing support and advice*".

While these issues are not entirely incompatible with a Chair's independence, they do highlight the difference of the Chair role from the Non-executive role.

The Code itself appears to treat the Chair as having different status from the other Non-executives, notwithstanding the new position of independence on an ongoing basis. For

example, he/she may not be a member of the audit committee or chair the remuneration committee.

It would be helpful for the FRC Guidance to clarify whether the change in the Code's classification of Chairs as independent on an ongoing basis requires any change in Chair behaviour or role.

**Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?**

We think there is merit in a simpler approach, with no maximum tenure stated and the focus solely on the requirement for annual re-election. However, we are aware that some of our investors have a preference for the clarity that a maximum tenure gives and providing informal guidance on this will assist with consistency of approach.

**Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?**

At Prudential we have a broad, business-focused diversity and inclusion (D&I) agenda. We aim to create a fair and inclusive working environment for all our employees, where individuals are empowered, differences celebrated and meritocracy fostered.

We aspire that our organisation, across all levels, appropriately reflects the populations of the countries in which we operate, as well as our customers and shareholders. This is reflected in our Group D&I Policy which aims to promote employee diversity, increase inclusivity and provide equal opportunities to all who apply for and those who perform work within our organisation, including our directors.

As part of our commitment to diversity, we have signed the HM Treasury 'Women in Finance Charter', which aims to increase the number of women working in senior management in financial services companies. We have set a gender diversity target of 30 per cent females in senior management by the end of 2021.

We agree that any increase in focus gained from the overall proposed Code changes will have a positive impact and agree that a focus now on building greater ethnicity and other diversity in the pipeline for succession has the potential to make a positive difference to the overall diversity of senior management teams and boards over time.

Each business will have particular diversity priorities. It is difficult to identify a single approach, as it might suit some parts of a business but not others. We are supportive of actions which attract a more diverse base of potential recruits into the industry, fosters meritocracy and, in the longer-term, increases the diversity of the pools of candidates available for future appointments. Group-wide succession planning is a key annual activity for us, culminating in a review presented to the board. The main focus of our succession planning process is the pipeline for senior and specialist roles, and incorporates looking at succession plans through a D&I lens.

We are supportive of Provision 17, the proposed expansion of the remit of the nomination committee to provide oversight of the development of a diverse pipeline.

**Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.**

At Prudential we believe that diversity of experience and background is vital to success, both today and in the future. We believe that the diversity of our employees and the inclusivity of our working environment enrich our organisation.

As a global organisation, with increasing mobility across the Prudential Group, our pipeline for executive roles is global. Our intention is for a diverse organisation which more closely reflects our markets and this may result in future priorities changing.

The focus in the draft Code on diversity beyond the board and on criteria other than gender is welcomed.

Within our overall Group-wide D&I strategy we have ten priority areas. Ethnicity is an important part of several of these and currently has equal weighting alongside gender and diversity of experience, including educational and professional background. Our concern would be to focus too narrowly on ethnicity could be at the detriment of other areas. Our preferred approach is to provide clear directional aspirations as opposed to specific targets.

We are supportive of the principle to enhance transparency to stakeholders and willing to support the necessary effort which would precede any requirement for reporting. We see an early challenge being creating consistent, and acceptable, definitions for ethnic groups, bearing in mind ethnicity data relies on individual self-definition.

**Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?**

We think it would be preferable to make Provision 4 a cross-reference to the relevant legislation on directors' duties. Having directors duties enshrined in two different documents with potentially different drafting may lead to difficulties of interpretation, compliance and level of liability.

**Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.**

We are content with the requirement to publish Audit Committee terms of reference moving from Code to Guidance. We believe it is established practice to publish all principal Committee terms of reference on company websites which issuer will continue to follow.

**Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?**

We understand the concern that levels of executive pay have contributed to public mistrust in business and agree that companies need to work to build that trust given the importance of business in the economy. We therefore welcome many of the FRC's proposals on remuneration, in particular, that committees should be able to exercise independent

judgement and discretion and override formulaic remuneration outcomes, and that long-term incentives should be subject to a vesting and holding period of at least five years.

We recognise that the board of directors should have oversight of workforce policies and practices to ensure that they engender trust, and provide security and stability for its employees. Executive pay should be set within the context of the reward arrangements for the wider organisation. However, care should be taken in expanding the remit of the remuneration committee, since many workforce policies and practices relate to matters other than reward (for instance, working practices and performance management arrangements), some boards may have or may establish committees better placed to provide oversight, for example, nomination, sustainability or values committees.

In practical terms, it is likely that boards or committees will discharge this duty by developing group-wide standards on workforce policies and practices, and by monitoring compliance with these standards through reporting.

**Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?**

We agree that it is important for boards to have meaningful powers to exercise discretion on remuneration outcomes. While most remuneration committees will already possess these powers, use them diligently and disclose their use in line with the provisions of the Investment Association's Principles of Remuneration, this provision raises standards for all.

**UK Stewardship Code**

Prudential as a group acts as both an asset owner and asset manager and will be contributing to the forthcoming Stewardship Code consultation in those capacities.

We see it as very important that requirements on issuers to produce disclosure and meet standards of behaviour under the Corporate Governance Code are mirrored by requirements on investors to engage meaningfully under the Stewardship Code, particularly to ensure that the "comply or explain" principle does represent a choice for issuers.

The move to "apply or explain" proposed above, together with further support from the FRC would, we believe, encourage proxy agencies and investors to engage with explanations that issuers make under the Code, avoiding statements that a company has "not complied" when in fact an adequate explanation may have been given.

M&G Investments (M&G) is part of M&G Prudential, the Prudential Group's UK savings and investments business. M&G is an international asset manager with more than 80 years' experience of investing on behalf of individuals and institutions.

M&G has been supportive of the FRC Stewardship Code since its inception and during the course of 2016 was awarded Tier 1 status for its reporting against the Stewardship Code by the FRC. We recognise the importance of accountability to our clients for the stewardship of their assets and comply fully with all of the Code's principles in respect of our UK holdings and aim to apply the same standards to our international holdings.

M&G will engage on any issue that may potentially affect a company's ability to deliver long-term sustainable performance and value. Issues may include, but are not limited to: business

strategy, performance, financing and capital allocation, governance, risk, management and employees, diversity, remuneration, culture, sustainability, environmental and social responsibility and/or quality of disclosure.

We expect the Boards of our UK investee companies to comply with the UK Corporate Governance Code (and with the spirit of it) and where this is not the case to clearly explain why.

We welcome the FRC's focus on issues that are central to our engagement strategy including greater reference to culture and diversity and specific guidance on taking account of the interests of the company's workforce and the impact on other stakeholders such as customers, suppliers, the community and the environment. We would support the Stewardship Code explicitly requesting that investors give consideration to company performance and reporting on adapting to climate change.

If you have any queries on our responses, please do not hesitate to contact me, or Helen Archbold, Head of Secretariat, on [helen.archbold@prudential.co.uk](mailto:helen.archbold@prudential.co.uk)

Kind regards

Alan Porter  
Group General Counsel and Company Secretary  
Prudential plc

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