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Revisions to the UK Corporate Governance Code

We refer to the consultation of the Financial Reporting Council (FRC) on a revised UK Corporate Governance Code, published on 5 December 2017, and we welcome the opportunity to contribute our perspective.

Norges Bank Investment Management (NBIM) is the investment management division of the Norwegian Central Bank (Norges Bank) and is responsible for investing the Government Pension Fund Global. We work to safeguard and build financial wealth for future generations. NBIM is globally diversified with GBP 50.7 billion invested in equities in the UK at the end of 2017. We regard the protection of minority shareholder rights as a necessary requirement to safeguard and promote the fund's long-term financial interests.

In addition to our response to the FRC's questionnaire, we would like to take this opportunity to make a few general remarks.

We recognise the importance of the UK Code in promoting high standards of corporate governance, and its role in influencing frameworks in other jurisdictions. The focus on best practice and the flexibility provided by "comply or explain" are key reasons for its success. As an investor, we are interested in hearing companies' explanations when they see a legitimate reason not to observe the Code's recommendations. We support the proposed restructuring of the Code, which will reinforce its principles-based approach.

As a globally diversified investor, we depend on the effective functioning of company boards to promote the interests of all shareholders. We support the FRC's focus on board independence as a core element of good corporate governance. We expect a majority of shareholder-elected board members in listed companies to be independent of management, dominant shareholders and business partners. This is an important safeguard to protect minority shareholders against potential abuse. We also agree with the FRC that the board should be diverse, and thereby exposed to new ideas and expertise from individuals without links to the company.

While Provision 15 of the current Code provides very useful criteria to determine board independence, we believe that there is no perfect measure of true independence and so

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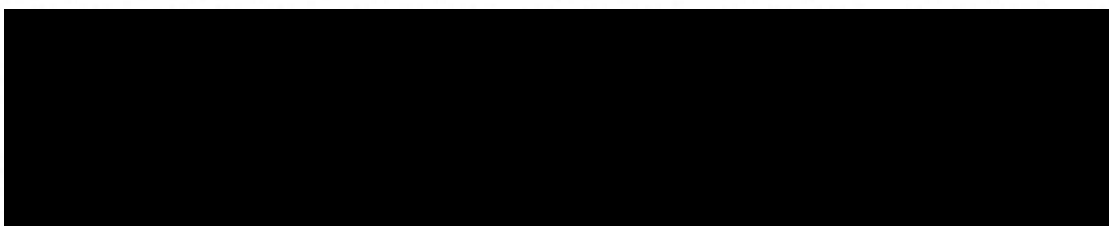
these criteria work better as “flags” rather than strict requirements. In addition, we do not think it is always necessary for the board chair to be independent throughout his or her tenure. We consider that the current requirement for independence upon appointment is a reasonable measure that balances experience and independence.

We welcome the approach on executive remuneration. We support the FRC’s proposals on minimum holding periods for equity-based remuneration of five years. We also welcome the suggestion that an even longer lock-in period, including post-employment, may be appropriate. The FRC’s focus on clarity, simplicity and long-term shareholding is in line with our position. Following the introduction of “say on pay” in many markets, we published our views on executive remuneration in 2017, emphasising transparency on total pay and long-term shareholding.¹

With such a lock-in mechanism in place, we recommend that companies abandon performance conditions for long-term shareholding. It is our view that long-term shareholding will better align CEO and shareholder interests than so-called long-term incentive plans with performance conditions. Substantial long-term equity exposure reinforces the intrinsic motivation of the CEO to succeed and contribute. It removes the distractions embedded in the design of many of the current incentive plans.

Finally, we support the Code’s general assertion of the differing roles of board and management. At the same time, we note that some of the proposed changes may blur the division of responsibilities, in particular having the remuneration committee of the board oversee all pay structures throughout the company. We believe that operational tasks should remain the responsibility of management rather than the board.

We appreciate your willingness to consider our perspective, and we remain at your disposal should you wish to discuss these matters further.



Enclosure: Response to consultation questions

¹ For more information on NBIM’s position on executive remuneration, please refer to our position paper from April 2017, available at www.nbim.no/en/responsibility/our-voting-records/position-papers/ceo-remuneration/

Enclosure: NBIM answers to FRC consultation questions re. proposed revisions to the UK Corporate Governance Code

UK Corporate Governance Code Questions

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

No.

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

No.

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

In line with the G20/OECD Principles of Corporate Governance, NBIM expects company boards to take into account the interests of all relevant stakeholders.

Concerning the engagement with employees in particular, we consider that all three proposed methods could work, and we suggest that the company chooses the most appropriate mechanism for its specific situation.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

We support the reference in the revised Code to companies' role and contribution to wider society, which is in line with the spirit of international standards. We do not see the need for the Code to refer more specifically to any specific standard.

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?

We recognize the FRC's objective to ensure that companies consult with shareholders in order to understand the reasons behind negative votes. We are supportive of companies engaging with their shareholders, following an unexpected voting outcome. In general, it is good practice that a company board is sensitive to lack of support, as expressed through votes against its proposals.

However, we think the current disclosure requirements are sufficient and we do not see the need for further mandatory reconciliation steps at this point. The FRC may wish to give companies and market participants more time to familiarise themselves with the recently increased publicity on vote outcomes.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

We agree with removing the exemption for annual re-election and the composition of audit and remuneration committees, but we concur with the FRC's concern that recommending an independent board evaluation for companies beyond FTSE 350 has the potential for disproportionate cost and other burdens, and hence we would not recommend the removal of this exemption. The removal of small-company exemptions underlines the importance of the intended flexibility provided by "comply or explain".

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 is a useful flag when considering whether a board member is still independent and nine years seems an appropriate time-period to look at.

However, tenure does not always negatively affect the ability to act independently. Among others, we have taken note of research indicating that boards can be more effective, as measured by firm performance, when independent board members were appointed before the CEO (i.e. relatively long-tenure). Therefore, we would not recommend a strict application of the nine-year criterion for independence.

In addition, the requirement for the board chair to be independent throughout the tenure effectively extends the application of the “nine year rule”. We believe the current requirement for independence upon appointment is a reasonable measure that balances experience and independence.

While Provision 15 of the current Code provides very useful criteria to determine board independence, we believe that there is no perfect measure of true independence and, therefore, these criteria work better as ‘flags’ rather than strict requirements.

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

Yes, we agree

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

We agree with the FRC that diversity, across multiple dimensions, may help boards make better decisions. As an investor, we are concerned that persistent underrepresentation of women may be an indication that a board is recruiting too narrowly in terms of background and experience, and that it does not have a systematic view of the full range of skills and qualifications required to be effective. We support measures that ensure companies are identifying and considering a diverse pool of candidates. We also believe that boards whose gender composition reflect that of wider society will enjoy greater legitimacy in the long run.

We see the benefits of expanding the remit of the nomination committee in order to provide oversight of the development of a diverse executive pipeline. The strategic and operational implementation, on the other hand, should be the responsibility of management.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

No view.

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.

No view.

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?

No view.

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.

No remarks.

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 would be careful not to blur the division of responsibilities between board and management. We believe management has the responsibility and the necessary qualifications for defining pay policies across the wider work force, while the board, assisted by the remuneration committee, sets the remuneration for the CEO and is involved in the remuneration for other top executives.

The revised code recommends that the chair of the remuneration committee should have served on a remuneration committee for at least a year (provision 32). While we understand the intention behind this proposal, it imposes an additional restriction on board composition, which is already a complex process.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

We welcome the proposed changes to lengthen the time horizon on equity-based remuneration.

First, we support the lengthening of the minimum total holding period to five years. Second, we support the suggestion that an even longer holding period may be appropriate. Third, we endorse the idea that the obligatory holding period should not be impacted by the termination of employment. These measures have the potential to lengthen the time perspective of management decision-making, in particular when combined. We outline our thinking in more detail in our [position paper on CEO remuneration](#).

Furthermore, having lengthened the lock-in period as discussed above, we recommend that companies abandon performance conditions for the equity-based part of their remuneration. In this revision of the code, we suggest that the FRC includes language in support of companies abandoning performance conditions, provided that a substantial part of the total remuneration is locked in for minimum five years independent of employment termination. Such language would provide encouragement to companies considering adopting such a simplified approach.

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

We support the language as well as the idea that boards should exercise discretion.

In our view, the remuneration approach we have outlined above would remove many of the problematic situations that call for discretion. In particular, this approach would remove the difficult vesting decisions facing boards when circumstances have changed in unexpected ways.

UK Stewardship Code Questions

No changes to the stewardship code have been put forward by the FRC so far. Questions may guide a future review. We have not proposed any responses to these questions.

Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?

No remarks.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

No remarks.

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?

No remarks.

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

No remarks.

Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

No remarks.

Q22. Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

No remarks.

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?

No remarks.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

No remarks.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

No remarks.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

No remarks.

Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

No remarks.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

No remarks.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

No remarks.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

No remarks.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

No remarks.