28 February 2018

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Financial Reporting Council
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Response submitted via e-mail

Dear Catherine,

Proposed revisions to the UK Corporate Governance Code (FRC consultation paper)

Thank you for inviting comments on proposed amendments to the Corporate Governance Code (hereafter 'the Code'). Our comments are primarily made from the context of non-life, wholesale insurance and reinsurance risks. We propose to make some general comments on corporate governance and the current Code before addressing the specific consultation questions.

The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. It exists to promote and enhance the business environment for its members. The IUA's London Company Market Statistics Report shows that overall premium income for the company market in 2016 was £22.725bn. Gross premium written in London totalled £16.034bn, while a further £6.691bn was identified as written in other locations, but overseen by London operations. For further information about our organisation and membership please visit our website, www.iua.co.uk under the section 'About the IUA'.

General Comments on Corporate Governance and the Code

IUA members continue to take great interest in corporate governance developments and have contributed to a wide range of regulatory and other relevant work streams; in particular, the PRA work on board responsibilities, the BIS paper on executive remuneration, consultations relating to the Walker Review and significant influence controlled functions and on previous revisions to the Code. Most recently, we responded to the UK government Green Paper on corporate governance. Farther afield, we have contributed to work undertaken by the IAIS, OECD, EIOPA and the European Commission on various aspects of corporate governance.

With the above in mind, we would summarise our policy approach to corporate governance as thus:

- The outcome of the Walker Review and subsequent amendments to the Code and reviews of executive remuneration have led to sensible and broadly welcomed changes to the corporate governance framework in the UK. Though there have been a small number of high profile

company failures in the recent past, we continue to be of the general view that the UK corporate governance regime, including the Code and 'comply or explain' principle, is fit for purpose and achieves a suitable balance. In cases where problems have occurred, these have largely been due to the specifics of the company itself rather than the governance framework per se. Whilst the need for incremental change inevitably arises over time, care needs to be taken not to damage the fundamentally well-functioning processes currently in place.

- We are supportive of adopting a graded, less prescriptive, proportionate approach to corporate governance in the (re)insurance industry and see the ongoing application of this principle as crucial in developing an effective and fair framework in our sector. We additionally believe that market-led initiatives (such as the ABI work on remuneration) or collaboration with the regulator / government is more effective than legislation.

- Many of our member companies are part of groups with parent companies not domiciled in the UK. Care needs to be taken, particularly when looking at issues such as caps or deferment of executive pay, that the UK economy as a whole is not adversely impacted by disproportionately onerous or restrictive corporate governance measures.

- A wider concern across the insurance sector is that the increasing pressure and prescriptive rules in relation to Non-Executive Directors (hereafter 'NEDs') may cause the NED 'talent pool' to shrink even further, or at least drive up the costs in attracting and retaining them. There is nothing in the proposed Code amendments which raises significant concern in this regard, but any proposals need to be considered in light of other regulatory initiatives, principally the Senior Managers and Certification Regime, which the FCA / PRA are currently extending to insurance.

- The government has mooted the possibility of developing more formal corporate governance rules that would apply to private companies. In our view, consideration needs be given as to whether it is necessary at the present time; whether there is a sound case for it; whether it is feasible given the wide range of private businesses; what trigger would be used (assuming there was a threshold excluding smaller private businesses); and the potential impact on investor appetite if more intrusive reporting requirements are put in place across the board. Consequently, if reform is deemed necessary, development of a voluntary code building in high-level corporate governance principles and guidance, or more targeted individual measures would be preferred.

- In relation to executive pay, our position has not fundamentally changed from that expressed in our response to the BIS consultation paper on remuneration a number of years ago, namely that:

    1. All remuneration should be clearly outlined, transparent to shareholders and aligned to specifically stated corporate outcomes developed in a risk management framework and subject to suitable internal controls and governance. The vast majority of applicable

companies in the insurance market follow these principles and there has not been the fundamental problems and adverse publicity experienced in other financial sectors.

2. In our sector, the FCA SYSC rules relating to effective management of risk and prudent management provide a flexible start point for consideration of firms' remuneration policies. We would expect such policies to be underpinned by long-term incentives for management performance and considered bonus payments and severance conditions for senior executives and board members.

3. Any rules or guidelines on executive remuneration should be interpreted flexibly and proportionately to cater for different business sectors, market practices and size of firm. A 'one size fits all' approach, inevitably based on large company executive remuneration structures, would likely be inappropriate.

- There are specific rules on remuneration that were introduced for Solvency II insurers in 2016 which, amongst other measures, introduces a threshold/limit, deferral requirement of three years for at least 40% of variable remuneration. This illustrates a wider point that care needs to be taken to not create tensions between different requirements in different industries and perhaps to only introduce measures in industries that are not currently regulated / do not already have remuneration requirements in place.

- Stakeholder engagement is important and should be built into company's' business processes. We tentatively support a high-level recommendation (and accompanying guidance) that companies should ensure that appropriate account is taken of stakeholder interests. However, more prescriptive rules in this area would not be appropriate.

We do not think that any of the proposed amendments to the Code are inherently in conflict with our general principles on corporate governance. We see the value in simplified, more concise Code provisions and support the enhanced focus on aligning the company's purpose, strategy and values with an objective of long-term success. However, we do hold concerns on several of the specific proposals, which are highlighted below. More generally, whilst we support the continued reliance on the 'comply or explain' modus operandi, there does seem to be an increased emphasis on reporting. We would stress that the 'comply or explain' provisions require flexibility in application and should not be constrained by overly rigid reporting procedures.

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

No, application from 1 January 2019 would be reasonable.

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 some circumstances, yes, but the proposed methods should not be deemed an 'all or nothing' approach to compliance with the Code. Companies have differing approaches to stakeholder engagement and we think it is crucial to maintain that flexibility, though within the boundaries of the Directors duties as per the Companies Act 2006. Similar to the drive to increase board diversity, stakeholder interaction is an important factor in companies making the correct business decisions and is clearly something that companies are increasingly aware of and tapping into.

We recognise that the options noted in the UK government Green Paper will be beneficial in some circumstances and evidence suitable stakeholder engagement. However, we would not prescribe or mandate any of these methods given that industry sectors and firms will have differing considerations and views on maximising stakeholder engagement. Ultimately it is for the board to decide (and be subject to scrutiny on) the methods of stakeholder engagement used and the extent to which it is then taken into account. This principle would, we think, be largely consistent with developing an overarching recommendation (or expectation based on the 'comply or explain' trigger) that companies should ensure that appropriate account is taken of stakeholder interests.

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?

No.

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?

Yes, 20% would, we think, be considered significant. Our starting position is that the existing voting regime is essentially fit for purpose in giving stakeholders a suitable platform to voice concerns but to allow the company to proceed as the elected board considers most prudent. However, increased interaction with stakeholders, particularly those dissenting, is not objectionable in principle and should help the company further understand its shareholders views. That said, it is not clear why the objection notice could not be addressed in the next annual report rather than in the six months after the vote as it would have the same practical effect but not incur additional administrative costs.

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.

Yes, though subject to the following comment.

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We support the broad principle underpinning the proposal but feel that it may be disproportionately costly, both financially and administratively, and in many cases unnecessary. Therefore, whilst the 'comply or explain' principle would generally apply, it may also be worth adding specific reference in the guidance or Code provision to proportionality for smaller entities.

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

Yes, though the ability of the company to derogate from the general rule, in line with the 'comply or explain' principle, remains important. More generally, it is not evident that there is a proven need to move away from the existing Code reference to the board deciding that a NED is independent to the presumption of non-independence. On balance, we would retain the existing emphasis on board control.

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

Yes.

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?

Yes. Gender and other diversity on boards and in the wider executive is an important factor for companies in ensuring that they maximise the expertise available to it and clearly needs to be built into a company's recruitment processes. However, we would be wary of being overly prescriptive in rules on this and feel that the profiling of board and executive required skills should be evaluated from the needs of the company as a whole and the best candidate, whatever gender or ethnicity, should ultimately be the key factor. However, we do not object to the proposed reporting requirements and focus on nomination committees in its approach to diversity.

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.

Yes, in principle, but again subject to the 'comply or explain' principle so that those much smaller entities are not disproportionately impacted by increased administration and recruiting costs.

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.

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The proposals are laudable but, as stated in the consultation paper, data may be limited. Consequently, encouraging companies to be more transparent and to consider ethnicity in recruitment policies is probably as much as can be done at present.

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?

Yes.

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.

Yes.

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?

Fundamentally, it is not established that there is a widespread problem with executive pay which cannot be adequately managed via existing governance rules. One needs to consider whether substantial revisions to the rules in this area will be disproportionately onerous, both operationally and financially, to the vast majority of companies who have strong controls in place. With that in mind, we would make the following comments:

1. The extended remit will be a big change for many remuneration committees in applying a more general supervision of workplace pay and policy – which could extend into areas such as recruitment, retention, workplace practices, training and performance management. This will require additional time to be served by relevant NEDs and/or appointment of new expertise – with the consequent economic and administrative implications for the company and the potential availability of NEDs. We note the helpful clarification by the FRC that some of this may be taken on by other board committees but ultimately they would have to interact with the remuneration committee, who would need to have a broad understanding of their work;

2. We would question whether the extended remit would include fees paid to NEDs (our initial assumption is that it does);

3. We agree with the board ability to exercise independent judgement and secretion and, where deemed appropriate, to override formulaic remuneration outcomes;

4. We do not object to the requirement that a remuneration committee chair needs to have sat on a remuneration committee for at least a year to take on the role. This is because we would expect the chair to have had some level of experience in being able to fulfil their role effectively. We note that the FRC confirms that sitting on any remuneration committee, presumably irrespective of size of the company or sector that it is trading in, would be suitable and, on balance, we think this is right. More generally, though, it is slightly anomalous to require this of the remuneration committee only and not of other board appointed committees (though we are not suggesting that the provision be applied elsewhere).

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

Our starting position on the application of LTIPs are that, whilst remuneration policies should support performance and encourage the underlying long-term business health of the company, there needs to be flexibility for companies to adopt both the level and type of performance measures according to their own specific corporate structure and business objectives. 'Restricted share' awards should be an option that companies can employ in this regard. We also understand that variable remuneration options for NEDs, currently possible with shareholder approval, will no longer be allowed under the Code. Though corporate practice appears to be moving away from this, it is an arguably unnecessary restriction on the company.

On share options, our general position has been that the current Code guidance is about right, but if there is compelling evidence that a three year vesting period is too short then amendments to the guidance should be considered. That said, one might imagine that moving from a minimum three to five years might lead to an overall increase in pay needing to be offered to incentivise executives. One also needs to consider the measures that insurers are subject to via the application of Solvency II (see our general comments above).

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

From our position as a trade association, it is difficult to judge this.

UK Stewardship Code

We are not best placed to comment on the operation of the UK Stewardship Code and therefore do not propose to respond to Questions 17-31.

We hope our comments are helpful in the assessment of a revised Corporate Governance Code. We would be pleased to clarify or expand upon our comments as required.

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Yours sincerely

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