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Catherine Horton
Financial Reporting Council
8th Floor
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28 February 2018

RE: Consultation on the proposed amendments to the UK Corporate Governance Code and Guidance on Board Effectiveness issued in December 2017 by the Financial Reporting Council

Dear Ms. Horton,

Thank you for giving us the opportunity to provide our comments on the proposed amendments to the UK Corporate Governance Code ("The Code") and the Guidance on Board Effectiveness ("The Guidance").

About Black Sun

Black Sun is an internationally recognised, market leading stakeholder communications company. We help businesses articulate their purpose and communicate how they deliver value by developing inspiring communications that reach, engage and influence important stakeholders. The result is that organisations are more valued in the eyes of their stakeholders. We encourage best practice in corporate reporting and believe that communications can act as a useful tool for stimulating internal discussions.

We regularly work with over forty FTSE 350 companies, including some of the UK's leading reporters such as Coca-Cola Hellenic Bottling Company, Go-Ahead, G4S and Antofagasta. We are passionate about demonstrating thought leadership within the industry and we recently published the 12th edition of our flagship Complete 100 research¹ which assesses the corporate reporting trends among the FTSE 100. We have also held a number of roundtables with our clients to discuss what the upcoming changes to the Code will mean for their reporting. In October we held a joint event with the FRC, attended by nearly 100 corporates, to discuss the upcoming changes in the reporting landscape. We also maintain a database of best practice reporting examples to help our clients understand what good looks like.

Summary of our response

Overall we welcome the proposed changes to the Code and Guidance as well as the FRC's new mission to promote transparency and integrity in business. We believe it is appropriate for the Code to make reference to companies' contribution to wider society as the impact a company has on society as a whole ultimately impacts its ability to create value over the long term. Investors are increasingly acknowledging this point. For example, BlackRock CEO Larry Fink's 2018 letter to CEOs highlights that 'to prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society'.²

We also support the new streamlined structure of the Code and the focus on company-specific reporting on the application of Code principles. However, we emphasise that the focus should be on the *outcomes* of governance practice and reporting and that corporate governance should not be seen simply as a compliance exercise.

We believe that meaningful disclosure of how companies have applied the principles of the Code and how this supports long-term value creation is of crucial importance for investors. However, care needs to be taken to ensure that narrative reporting is promoting accountability and that stakeholders have faith in the credibility and completeness of narrative disclosures. The Board's responsibility to provide a fair, balanced and understandable assessment of the Company is therefore more important than ever.

We also acknowledge that while greater transparency and a more company-specific approach to reporting are crucial for building trust in UK businesses, reporting must be backed up by meaningful change within companies. Towards this end, a more holistic approach to reporting can help to open internal conversations by bringing together people from across the business. The annual reporting process can also help to put issues such as the company's impact on wider society on the Board agenda. However, in order to achieve these benefits, boards must be engaged in the reporting process and use external reporting as an opportunity to consider internal processes.

We believe that it is important that the approaches taken to governance and stewardship are aligned to ensure that the system of shareholder scrutiny of companies' governance practices functions properly. We also encourage the FRC to continue promoting transparency and accountability across the entire investment chain.

¹Black Sun, Complete 100, 2017. Request a copy [here](#).

² Larry Fink, Letter to CEOs, 2018. Read the letter [here](#).

Linking governance and strategy

We have observed in our work with clients that the FRC's focus on increasing linkages between content elements in the annual report has led to greater involvement of internal stakeholders from across the business in the annual reporting process. Our research into the benefits of integrated reporting, which has a similar focus on connectivity, showed that out of 66 organisations who have adopted integrated reporting, 78% saw a benefit in more collaborative thinking about goals and targets by the Board, executives and strategy departments and 84% saw a current benefit regarding the quality of data available to management.³

We therefore welcome the recommendation for companies to include: 'signposting and cross-referencing to those parts of the annual report that describe how the [Code] principles have been applied' as thinking holistically about reporting can have internal benefits as well as providing more useful information for external audiences. However, linkages between the governance statement and strategic report need to be credible and meaningful.

Some reporters are already outlining the Board's role in overseeing each of the Company's strategic objectives in their governance statements. However, this is a relatively new trend and most companies are yet to draw this clear link between board oversight and strategic delivery. Over the last few years companies have attempted to provide more narrative insight into how the Board functions. However, these discussions are often focused on 'business as usual' topics such as board site visits or directors' induction programmes. While this information is valuable, we believe it would be more useful for companies to provide insight into how the Board oversaw the key strategic developments outlined in the strategic report.

Companies can also provide more forward-looking insight in their governance statements in order to demonstrate how the Board will support value creation over the long term. Companies can do this through improved disclosure around the link between succession planning and strategy. For this link to be truly insightful we believe that companies should include a strategy and skills gap analysis that explicitly identifies the skills required for the Company to achieve its strategy, discusses these in line with the skills of the directors, identifies any areas in which the Board needs to improve its skills to support the strategy, and discusses how the succession plan is responding to this gap. However, we find that at present only 25% of FTSE 100 companies provide even a basic link between succession planning and strategy.

Reporting on stakeholder considerations

We welcome the focus on explaining how directors' duty to promote the long-term success of the Company and in doing so have regard for wider stakeholders has impacted board decision-making. We argue that disclosure and transparency on this front will serve not only to contribute to establishing trust among wider stakeholders, but will also demonstrate to investors that the Company is taking steps to avoid reputational risks that can destroy shareholder value in the short, medium and long term.

We find that many of our clients are already engaging with stakeholders internally but are not currently reporting on this externally. We believe that requiring directors to publicly articulate how they have taken stakeholders into account in key decisions will encourage them to incorporate stakeholder feedback into their decision-making process and to consider stakeholders in the context of strategy and long-term value creation. We therefore believe it is important that companies evidence how stakeholders were considered in key decisions and do not simply disclose how stakeholders are engaged on an ongoing basis.

From our point of view, the key challenge in implementing reporting on stakeholders is ensuring that it adds valuable insight and does not become boiler-plate. We believe it is important that companies are encouraged to focus only on the stakeholders most material to their business in their annual reports, especially as other reporting initiatives such as the Non-financial Reporting Directive are also adding new reporting requirements.

Culture and diversity

We welcome the FRC's recent initiatives on culture and diversity including the culture and succession planning projects. According to our Complete 100 research, 66% of FTSE 100 companies now outline their values in the annual report. However, we find that companies can do more to evidence how culture is embedded. We see that while 46% of Chairman's governance letters now include a commitment to promoting a positive board or company culture:

- Only 3% of FTSE 100 companies include a principal risk relating to culture and values.
- Only 4% have KPIs relating to culture or values.
- Only 8% discuss progress made in embedding values.

We believe diversity and stakeholder engagement are two sides of the same coin and feed into the broader discussion around corporate culture. Companies need to reassure shareholders and other stakeholders that the Board has a sufficient level of diversity of perspective and background to reflect the Company's strategy, markets and stakeholders. By the same token, the Board also needs to establish mechanisms for receiving stakeholder information that is useful, informative and relevant to their market and strategy.

We are thankful for the opportunity to provide our comments and we will be happy to discuss any of the issues raised.

Yours sincerely,

Sallie Pilot, Chief Engagement and Insight Officer

³ Black Sun, Realizing the benefits: The impact of Integrated Reporting, 2014.

Response to select consultation questions

Introduction

Question 1 - Do you have any concerns in relation to the proposed Code application date?

We believe that from a reporting perspective, applying the Code for years beginning on or after 1 January 2019 provides sufficient time for companies to prepare for the changes. However, we suggest that it would be helpful for the introduction of all the new requirements coming out of the Guidance on the Strategic Report update, the Government's secondary legislation and the Corporate Governance Code to be aligned as they pursue overlapping aims. We also believe co-ordinating the introduction of these initiatives will make it easier for companies to manage the changes and encourage boards to consider them holistically. We acknowledge, however, that the timing of secondary legislation is beyond the FRC's control.

Question 2 - Do you have any comments on the revised Guidance?

We welcome the format of the revised Guidance and, in particular, the 'Questions for boards' feature which we believe will be a good device for provoking internal thinking about Board practices. We also support the inclusion of input from stakeholders and expert opinions as part of the section on decision-making as we believe this will encourage companies to consider stakeholders more strategically. The discussion of culture also provides useful practical guidance on how companies can implement and embed a desirable culture in practice. We encourage companies to consider the Guidance when developing content which can be reported externally. For example, the guidance on decision-making, particularly paragraphs 17, 18 and 19, will be useful when reporting on how key strategic decisions have been discussed by the Board.

Leadership and purpose

Question 4 - 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?

Companies are faced with a wide range of sometimes conflicting indexes, reporting frameworks and principles on ESG matters and it can be overwhelming for them to know what frameworks to adhere to. Including reference to frameworks or principles that, in the FRC's opinion, support the goals of the Code in the Guidance would therefore be useful. However, we believe it would be too prescriptive to refer to specific frameworks in the Code itself at this stage.

We note that there is a clear overlap in the long-term goals of the UK governance and reporting framework and the IIRC's International Integrated Reporting (<IR>) Framework. We believe it would be helpful to include a reference to the <IR> Framework in the Guidance to help UK companies understand that the two frameworks complement one another.

Composition, succession and evaluation

Question 9 - 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?

We are supportive of the changes to the Code to promote greater consideration of how diversity is promoted in the boardroom, in the executive pipeline and in the Company as a whole. We believe, as is highlighted in the proposed revisions, that the business benefits of diversity are clear.

At present we find that 66% of FTSE 100 companies include a simple statement of commitment to ensuring a diverse promotion or nominations process but only 16% include an actual explanation of how a diverse promotion or nominations process is ensured. We are hopeful that the new requirement for companies to report on the actions the nomination committee has taken to oversee a diverse pipeline will keep diversity on the Board agenda and that stakeholders' ability to compare the explanations of different companies within the same sector will encourage companies to take concrete steps to tackle the issue. We also believe the requirement to explain how diversity supports the Company in meeting its strategic objectives will be a useful exercise to stimulate internal discussions.

As a final consideration, we are already seeing that some leading reporters are acknowledging the importance of the nomination committee in the work of the Board as a whole by opening the governance statement with the nomination committee report. We believe this is a useful innovation as it is the nomination committee that, in the first instance, ensures the Board has the correct people in place to carry out its duties effectively. We consider that the new requirements, especially the link between diversity and strategy, are complementary to this approach.

Question 11 - 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 Black Sun, we believe that all aspects of diversity should be considered holistically. We note the arguments presented in the Parker Review which highlight that ethnic diversity on boards provides clear internal and external business benefits, including better engagement with an increasingly diverse range of stakeholders.⁴ We therefore believe that ethnicity is an important component of a balanced overall approach to ensuring that the Board has

⁴ Sir John Parker, Parker Review Committee, 'A Report into the Ethnic Diversity of UK Boards', October 2017, page 8. Read the report [here](#).

adequate skills to understand its key stakeholder groups. Requiring companies to report on ethnicity levels in executive pipelines externally may stimulate internal discussions and provoke action to ensure boards adequately reflect the Company's stakeholders. We do, however, acknowledge the practical challenges our clients face when collecting data to meet new reporting requirements and that these challenges will vary according to the size, location and circumstances of different companies.

Our thoughts on stewardship

Black Sun considers that it is crucial to promote transparency and accountability across the entire investment chain. While it is important that companies continue to improve the quality and credibility of the information they provide to investors, it is also important that the investment community, including sell-side analysts and proxy advisers as well as institutional investors, are held accountable for how they use that information to inform engagement activities and promote efficient allocation of financial capital.

We argue that it is important that investors are encouraged to incorporate 'wider stakeholders' into their engagement and monitoring activities. We believe companies will be more likely to integrate stakeholder considerations into their strategic decision-making in a meaningful way if they feel they are being scrutinised by investors on these issues.

We believe that the Stewardship Code and UK Corporate Governance Code should complement one another and that the outcomes of both should be aligned. We therefore agree that best practice expectations should be promoted using a comply or explain format in order to be consistent with the Code.

Similarly, as companies are encouraged to provide more company-specific insight into the application of Code principles, we believe the FRC should continue to work to promote best practice reporting on stewardship principles. We believe that beyond the tiering exercise, sharing examples of what good reporting looks like in practice is one way in which the FRC can encourage better reporting on stewardship activities. We know from our experience working with companies that our clients have traditionally responded well to practical examples. A database of best practice examples or an initiative similar to the Financial Reporting Lab are both potential ways in which the FRC can facilitate the sharing of ideas on best practice stewardship reporting.