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Proposed revisions to the UK Corporate Governance Code

PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

Introductory remarks

The Financial Reporting Council's (**FRC**) overall aim to streamline the UK Corporate Governance Code (**Code**) is to be welcomed. We feel that it is right that the FRC, in conjunction with the government and as part of the package of reforms to the UK governance regime, takes the opportunity to further strengthen that regime by attempting to make it fit for the longer term. The incremental addition of Supporting Principles and Provisions has arguably led to too great a focus on compliance with Code Provisions and not enough focus on the application of its Principles. Many of the current Provisions sit far better as guidance and, subject to our comments below, we agree with the FRC's decision to reposition them accordingly.

However, we do have concerns that in some respects the proposed reforms potentially undermine the flexibility that the "comply or explain" principle creates which, in our view, underpins the UK's system of governance and gives it its inherent strength. No governance regime, whether code based or framed in legislation, can prevent every corporate failure and any attempt to do so will stifle entrepreneurialism and wealth creation. We believe it is important to ensure that the Code does not become, in relation to any issue, "comply or else".

Broadly, we agree with many of the proposals in the draft Code. However, various issues, including as regards stakeholder and particularly employee engagement, and the determination of director independence need, at the very least, clarification to re-assert the primacy of the board's decision-making (after due consideration and, in certain circumstances, investor consultation) as to what is best for an organisation relative to its prevailing circumstances. This is particularly the case given the intransigence of certain proxy voting agencies who clearly take a "comply or else" approach when making their voting recommendations.

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

It is assumed that the proposed Code is to be finalised during the early part of Q3 2018 and will apply to financial periods beginning on or after 1 January 2019. On that timetable, we have no significant concerns as long as it is made clear that voting during the 2019 AGM season should be on the basis of the application of the 2016 Code. The FRC should also make it clear that any early adoption of the proposed Code should be as a matter of best practice and no more. Thus, a company outside the FTSE 350 and with a 31 December year end which does not meet the board or committee composition requirements of the proposed Code (as currently drafted) should not have to explain an issue of non- compliance in its annual report for the financial period to 31 December 2018.

Q2 Do you have any comments on the revised Guidance?

The Guidance provides considerable practical assistance. However, we would urge the FRC to clarify the status of the "suggestions" it makes throughout the Guidance on the basis that we fear that some will evaluate the governance of companies and make voting recommendations based on a binary "comply or else" review of whether a company has followed each and every suggestion made.

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

As suggested by the use of the word "normally" in Provision 3, we believe the methods listed are only some of the methods through which companies can achieve meaningful employee engagement. We believe that it needs to be made clear that other methods, which will necessarily need to be clearly explained, are equally valid and will therefore allow a company to be compliant with this Provision. To do otherwise runs contrary to the fundamental flexibility which gives the Code its inherent strength.

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?

It is important that the Code and associated guidance does not create any confusion as to the primary duty of directors to, in good faith, promote the success of the company for the benefit of its members as set out in section 172, Companies Act 2006. The concept of "enlightened shareholder value" requires, to the extent relevant, a consideration of the impact of a decision in the longer-term but it should be remembered that, in certain circumstances, a directors overriding duty may be to make a decision which has its principal or sole impact in the short-term, but yet still benefits members and promotes the success of the company. The wording of Principle A and, in particular, use of the expression "long-term" has the potential incorrectly to characterise section 172 and, at best, to cause confusion or, at worst, create plurality.

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 agree with the 20% threshold.

We do not believe that requiring an update to be published after six months will lead to meaningful disclosure – we believe that many companies will simply reiterate the fact that they are engaging with investors on the subject matter in question. If the provision is retained, we believe that it should require disclosure of the "actions taken" in the six month period since the vote.

We would also suggest the FRC considers ensuring that the requirements of the Code dovetail with the Investment Association's register of significant shareholder dissent (**Register**). For example, at present there is no obligation in the Code to explain the reasons for the withdrawal of a resolution and yet such information is included in the Register with links to the company's RNS explanation as to the reasons for it having done so.

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 the principle of removing the exemption.

We do have concerns at the ability of companies to understand which organisations undertake evaluations given that it is still, relatively speaking, a nascent industry. Could a third party body, such as the Investment Association, be charged with creating a list of evaluers (on the proviso that it was made clear that inclusion of a name on that list was in no way to be seen as an endorsement of the abilities of an individual evaluer)?

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

We are concerned that the attitude of many proxy voting agencies will mean that this nine year rule could, in effect, become a nine year ceiling. Indeed, the "change of emphasis" relative to the list of factors in Provision 15 could have the same effect relative to each of those issues.

The drafting of the Code needs to make it clear that it is still possible for the board to determine that an individual is independent notwithstanding that the nine year period has been exceeded (and the existence of any other factors in Provision 15). We believe that the final sentence of paragraph 52 of the Consultation: "Companies still retain the option of offering an explanation if they believe than an individual is still independent", needs to be reiterated in the Code.

We also believe that the language of the Code as regards the operation of the nine year period which, for the sake of clarity and consistency, should be amended to: "nine years from the date of their *first appointment to the board*". The current drafting causes confusion and potentially permits nearly 10 years of service if a director is appointed soon after a company's AGM.

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

We agree.

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?

We agree.

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.

We agree.

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.

We believe that companies should be encouraged to do so as a means of promoting diversity. However, further guidance dealing with the legal constraints and practical approaches in collecting the data is needed to assist companies in a complex area.

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 Guidance and Transparency Rules or Companies Act?

We do not see duplication per se as problem however it would be helpful if the language used could be harmonised as much as possible.

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 do.

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 believe that more clarity needs to be brought to the intended role of the Remuneration Committee in this regard. We know that a number of companies are concerned (and it is a concern we share) at the potential for a non-executive committee to be drawn into a quasi-executive role and, as a consequence, for the ability of the Chief Executive to incentivise his / her team as he / she sees fit (albeit within any company pay policy set by the Remuneration Committee) to be inappropriately fettered. The proposal has the potential to weaken the link between senior management pay and performance and undermine the authority of the Chief Executive in relation to his / her direct reports. In particular, clarity needs to be brought to the intended interpretation of the words "determining" (Principle Q and Provision 33) and "overseeing" (Provision 33).

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

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

Other comments on the Code

Provision 3: Instead of "a director appointed from the workforce", we believe the Provision would read better / more accurately as: *"a person from the workforce appointed as a director"*.

Provision 13: We disagree with the first sentence which states: *"Non-executive directors are responsible for appointing and, where necessary, removing executive directors."* Executive appointments and succession should always be a matter for the board, based on the recommendation of the Nominations Committee. We agree that non-executive directors have a particularly important role to play in such matters but, as currently drafted, we believe that Provision 13 is inaccurate.

Provision 14: The requirement to explain in the annual report the reasons why a director has been permitted to take on external appointments is likely to result in meaningless, boilerplate reporting. It would cut clutter and drive more meaningful disclosure if the obligation was limited to circumstances where it would otherwise appear that a director does not have sufficient time to discharge his / her duties.

Provision 35: Although there is some duplication with Accounts Regulations Sch 8, para 22(1)(c), Provision 35 goes further stating that the Remuneration Committee should be responsible for appointing remuneration consultants (whereas the Accounts Regulations only require disclosure as to who appointed them). It is unclear in this context whether this Provision relates only to the extent that the remuneration consultants are advising on directors' or senior managers' remuneration. This is particularly the case given the wider role to be assigned to the Remuneration Committee in respect of "workforce policies" and the fact that remuneration consultants may well be engaged to advise on remuneration policies and structures throughout the business. Is it really the intention that the Remuneration Committee should have the responsibility of appointing remuneration consultants where they are advising on, for example, the integration of remuneration policies following a company acquisition where no directors or senior managers are involved?

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28 February 2018

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