

Response to the FRC's Proposed Revisions to the UK Corporate Governance Code

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

No. Assuming that a final version of the Code is published by early Summer 2018, there should be sufficient time for companies to be ready to apply the new Code to accounting periods beginning on or after 1 January 2019.

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

- 2.1 Generally speaking, this is a thoughtful and thorough document and the “boxed” questions and examples are helpful.

- 2.2 We do have a concern that the document is quite dense, with something of a “wall of sound” feel to it. Whilst it does not necessarily lend itself to an “Executive Summary”, might there be a crisp “Key Themes” section after the Introduction to bring additional approachability to the document?

- 2.3 More substantively, we have concerns around paragraph 30 which calls for directors to explain “*their decisions and how they have taken account of the interests of different stakeholders*”, including an exposition of the balancing of positives and negatives which the directors have gone through in relation to such decisions.

- 2.4 This, of course, will link to the secondary legislation which is envisaged to require directors of all companies of significant size (private as well as public) to explain how their directors comply with the requirements of Section 172 of the Companies Act 2006 to have regard to employee interests and to foster relationships with suppliers, customers and others (also reflected in Provision 4 in the revised Code).

- 2.5 Whilst directors currently shoulder the risk that their actions (and omissions) will be judged with the benefit of hindsight, this will potentially be brought into much sharper relief by provisions which require public articulation of certain matters to which they have had regard in the discharge of their duties.

- 2.6 Directors, faced with an important decision (say a major acquisition), will do their best to evaluate and balance all relevant factors on the basis of their current knowledge and the advice available to them. But if it subsequently transpires that there was, for example, an environmental problem that no-one could realistically have appreciated at the time there must be a risk that observers will look back at the description of factors balanced and say - "*How could you have missed that?*".
- 2.7 We believe that paragraph 30, and the proposed changes to Section 172, will change the risk profile for directors in a disproportionate manner. This is a very significant concern for directors and risks discouraging director candidates from seeking board positions.
3. *Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?*
- 3.1 The menu of three proposed methods is fine and has, of course, been well trailed.
- 3.2 There are, however, two areas of concern:
- (a) the expansion of "*employees*" to "*workforce*", whilst perhaps an understandable step, is challenging for directors because:
- it is inconsistent with Section 172 which requires regard to be had to the interests of "*the company's employees*". The Companies Act uses the term "*employees*" in a variety of contexts (see, for example, Sections 411 and 465) and so to introduce a new concept in Provision 3 is troubling; and
 - in that light, and more generally, how should the directors gather and weight the respective views of employees on the one hand and the wholly uncertain class of "*remote workers, agency workers and contractors*" on the other?
- This is problematic for directors and we would urge a return to "*employees*" within Provision 3;
- (b) the use of the word "*normally*" in Provision 3 is presumably a cross reference to paragraph 35 in the Board Effectiveness Guidance which clarifies that the three methods are not the only methods and boards should be open to innovative alternatives. It

would be clearer if this thought were specifically included in Provision 3.

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

No. Principles A and C and Provision 4 cover the ground.

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

- 5.1 We believe that the proposals relating to significant votes against resolutions are **overreaching** and **inappropriate**.

- 5.2 In the Government Response to the Green Paper consultation the topic of significant shareholder votes against resolutions is discussed solely in the context of votes on the Directors' Remuneration Report and executive pay (see paragraphs 1.45, 1.46 and 1.47). The FRC is invited *"to set out the steps that companies should take when they encounter significant shareholder opposition to executive pay"*. The subsequent reference to the Investment Association register speaks of executive pay or other resolutions but this is not reflected in the Executive Summary, where the register is described as covering listed companies *"encountering shareholder opposition to pay awards of 20% or more"*.

- 5.3 For some reason, this focus on executive pay is ignored in the new Code, and indeed in the IA register, and it is suggested (paragraph 36 of the Consultation Paper) that the Response addressed *"significant votes against resolutions at their annual general meetings (AGMs)"*.

- 5.4 The extension of Provision 6 in the new Code to require companies to explain what actions they propose to take to consult shareholders when more than 20 per cent of votes are cast against against **any resolution** (whether at an AGM or not) is overly intrusive and unwarranted. The Companies Act includes a clear regime for when resolutions pass or fail, more than 50% of votes for ordinary resolutions and 75% for special resolutions. This new Code provision in reality creates a new, and higher, threshold for all resolutions - effectively making all resolutions *"super special"* as companies have to explain themselves if they do not get to this level. Companies have only *really* passed a resolution if they get an 80% majority.

5.5 Whilst one might understand something of this sort for the especially sensitive subject of the Directors' Remuneration Report, it is simply wrong to seek to extend it to all resolutions.

5.6 It follows that the suggestion that there should be an update after six months is even more objectionable.

6. *Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years?*

We do not agree with the removal of this exemption. Independent evaluations can be expensive (upwards of £50,000) and very distracting for the company secretarial team and the directors. We believe that, for smaller companies, this expense and distraction is disproportionate.

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

Yes. boards need to be exposed to new ideas and new personalities and, after nine years on the board, directors may begin to be overly embedded in the organisation and thus lose objectivity and the will to challenge.

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

Yes. As the Consultation Paper says, there may be circumstances where it is appropriate for a non-executive director and/or chair to stay on beyond nine years and companies should be allowed the flexibility for this to occur with explanation.

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?*

9.1 The overall thrust of Section 3 is surely the right one, emphasising the need to promote diversity in the boardroom and within senior management not only of gender but also of social and ethnic backgrounds, cognitive and personal strengths. It is helpful for the remit of the nomination committee to include oversight of a diverse pipeline for succession. Building diversity at levels below the board is a challenge, as the Consultation Paper makes clear.

- 9.2 The key factor in actually driving change will be the reporting requirements included in Provision 23. The combined impact of these requirements should be to bring about some change as companies will need to articulate how the NomCo's appointments and approach to succession planning support the building of a diverse pipeline and what other actions it is taking to develop a diverse pipeline. Whilst there is a risk of aspirational statements, rather than action, there is a good chance that the requirements are specific enough to stimulate actual change.
- 9.3 Whether this flows down to more building of diversity across the company as a whole is dubious. Logically, the need to develop a more diverse pipeline should lead to more diverse recruitment at junior and intermediate levels but it will not be easy to entrench this, even with statements as to the importance of diversity to the meeting of strategic objectives.
- 9.4 We would note an additional material point. The laudable desire to build greater diversity in the boardroom may conflict with the developments emerging in the proposed amendments to Section 172 and the changes envisaged by Provision 4 of the new Code and paragraph 30 of the Guidance. More diverse candidates may well be discouraged by legal and Code changes which tend to increase the potential personal exposure of directors.
10. *Do you agree with extending the Hampton-Alexander recommendations beyond the FTSE 350?*
- Yes.
11. *What are your views on encouraging companies to report on levels of ethnicity in executive pipelines?*
- We cannot comment on the cost and other burdens involved in companies reporting on levels of ethnicity in executive pipelines, but intuitively it will be hard to drive change without transparency in relation to these statistics.

12. *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 and the Companies Act?*

Yes. The exercise of “*de-duplicating*” could well be painful, for limited benefit.

13. *Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code?*

Yes.

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

14.1 We do not agree with the expanded remit for the Remuneration Committee (“*RemCo*”).

14.2 The RemCo currently carries a significant work-load in setting remuneration for the board and “*recommending and monitoring*” the level and structure of remuneration for senior management. To change this by (a) upgrading the role in relation to senior management to a responsibility to “*set*” remuneration and (b) adding to that the responsibility for overseeing “*remuneration and workforce policies and practices*” is unrealistically burdensome.

14.3 One can see that a more forensic role for RemCo in relation to senior management might be desirable but workforce remuneration, plans and policies and practices will often be many and varied. The responsibility and work involved would be very significant.

14.4 The Consultation Paper appears to acknowledge the challenge here by saying that at some companies the RemCo might delegate these elements to other committees - but that, we assume, would leave responsibility with the RemCo.

14.5 Accordingly, we would propose that the responsibility for workforce remuneration, policies and practices continues to sit outside the Remuneration Committee. This is not to challenge the importance of a thoughtful approach to workforce remuneration and conditions (with the potential benefits outlined in paragraph 80 of the Consultation Paper) and of driving for greater alignment between executive pay and

wider pay policy. Perhaps another committee, such as the corporate responsibility committee, could take the lead in overseeing workforce remuneration and conditions and liaise appropriately with the RemCo with a view to improving alignment across the company.

15. *Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?*
 - 15.1 The themes outlined in paragraph 40 of the new Code for guiding executive remuneration policy - *clarity, simplicity, predictability, proportionality and alignment to culture* - are important ones for the RemCo to consider. Perhaps the description in the annual report of the work of the RemCo, as required by paragraph 41 of the new Code, could include a brief description, with examples, of the way in which the RemCo has had regard to these themes in determining executive remuneration policy and practices.
 - 15.2 As a further thought might some element of bonus of, say, the CEO or CFO be made dependent on feedback? Could some sampling of feedback from institutional shareholders, senior management and employees be combined into an index which would then be applied in determining what percentage of that element of bonus is actually awarded? Feedback will often play a role already in bonus awards but the idea here would be to make it a more tangible driver of bonus.
16. *Do you think that the changes proposed will give meaningful impetus to boards in exercising discretion?*
 - 16.1 The proposition in Provision 37 that “*Remuneration schemes and policies should provide boards with discretion to override formulaic outcomes.*” seems to us to be a challenging one.
 - 16.2 Remuneration schemes are contractual and participants will inevitably be wary of granting discretion to the company to override the results of the scheme, not least because views could readily differ as between senior executives and the company as to what a “*formulaic outcome*” looks like. Clearly caps can be inserted in schemes (and no doubt will be considered more actively post-Persimmon) but broad discretions will be difficult to craft in ways which are legally robust and acceptable to

participants. So, this is a topic which may well require further consideration and discussion.

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22 February 2018