



Governance Briefing

CORPORATE GOVERNANCE COMMITTEE (14 05 2018)

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For Information:

Updates on UK, EU and other International developments.

This paper provides a brief update on governance developments since the last Corporate Governance Committee meeting on 15 February 2018.

Corporate Governance

Whistleblowers Directive

The European Commission has officially proposed a **directive** on strengthening whistleblower protection as a means to unveil unlawful activities and help to enforce EU law. The **legislative package** provides high-level protection for whistleblowers who report breaches of EU law by setting new, EU-wide standards. The new law will establish safe channels for reporting both within an organisation and to public authorities. It will also protect whistleblowers against dismissal, demotion and other forms of retaliation and require national authorities to inform citizens and provide training for public authorities on how to deal with whistleblowers.

How Infrastructure is Shaping the World

Hildyard and Sol from the Corner House **explain** that infrastructure is not just roads, railways and airports, but also encompasses gigantic 'mega-corridors' that attempt to re-engineer whole landscapes and legal environments to speed up the circulation of capital.

Key observations on the Activism Environment in Q1 2018

Rossmann of Lazard's **identifies key trends** in terms of capital deployed and campaigns initiated, and the growing influence of passive managers.

Is There a Gender Gap in CEO Compensation?

Aguilera (Northeastern University & ESADE Business School), Judge (Old Dominion University), and Terjesen (American University & Norwegian School of Economics) **believe that** there is at least one prominent organizational position where gender has no influence on how much the person is paid, namely the CEO. Their research also casts doubt on the veracity of provocative claims such as 'female CEOs of the largest public companies are actually out-earning men' (Fortune 2016, May 10) or that 'though outnumbered, female CEOs earn more than male chiefs' (WSJ 2017, May 31). The truth seems to be that, once relevant confounding factors are accounted for, male and female CEOs earn similar compensation, which is what standard economic theory would suggest and most people would like to see happen in society.

Median Employee Pay Not Quite the Spectacle Anticipated....Yet May Still Spark Employee Relations and Media Fires

Lifshey of Pearl Meyer & Partners LLC, **says that** after eight years the ratio disclosure legislation isn't effective in highlighting inequalities, but ratios do meddle with employee relations and they attract short-lived media attention.

Future Unions: Towards a Membership Renaissance in the Private Sector

The Fabian Society has published **new research**, supported by a range of union leaders, which sets out a radical plan to reverse the decline in Trade Union membership and boost pay in the private sector.

Selecting Directors Using Machine Learning

In their **paper**, Erel, Stern, Tan and Weisbach present a machine-learning approach to selecting the directors of publicly traded companies. In developing the machine learning algorithms, they contribute to our understanding of governance, specifically boards of directors, in at least three ways. First, they evaluate whether it is possible to construct an algorithm that accurately forecasts whether a particular individual will be successful as a director in a particular firm. Second, they compare alternative approaches to forecasting director performance; in particular, how traditional econometric approaches compare to newer machine learning techniques. Third, they use the selections from the algorithms as benchmarks to understand the process through which directors are actually chosen and the types of individuals who are more likely to be chosen as directors counter to the interests of shareholders.

How a CEO's Cultural Background Impacts Firm Performance

In this **study** Nguyen, Hagendorff and Eshraghi ask : do the cultural values top managers inherit from their ancestors affect their decision-making today? They focus on US-born CEOs who are the children or grandchildren of immigrants.

Cyber risk reporting in the UK

Deloitte have completed their second **review of cyber reporting by the UK's FTSE 100 companies**. They have considered whether companies describe cyber risk clearly, whether boards demonstrate ownership, whether mitigation activities are well explained and whether cyber security breaches are described.

Governing Cyber Risk: A Guide for Company Boards

TheCityUK has collaborated with Marsh, and **their report** warns that cybercrime is now the biggest risk for financial and related professional services firms and that company boards must do more to address the threat. The report focuses on the need for boards to have robust governance systems in place to manage cyber risk, and outlines a new framework to help them meet this challenge.

Cyber risk management guide

The International Security Alliance has published a **new handbook** which explains: the legal landscape in the Germany, the UK, and the European Union; the acceptable cybersecurity standards used in Germany, the UK, and EU; the roles of key management; how to plan for and respond to cybersecurity incidents; and how different board structures affect cyber-risk management.

A Look Under the Hood of Spotify's Direct Listing

Graber, Lopez and Basham, Clearly Gottlieb Steen & Hamilton LLP, **report that** Spotify finally went public, following an unusual path known as 'direct listing'—the shares started trading on the New York Stock Exchange, without any of the contractual or marketing arrangements that attend a typical IPO. No traditional road show or bookbuilding, no allocations. No one promising to sell, no underwriters promising to buy. The company even declined to ring the opening bell.

Sustainability

Integrating ESG into benchmarks

In **'Foundations of ESG Investing'** MSCI test whether two ESG indexes can be used for total portfolio and individual allocations. They examine whether the indexes met four key tests for benchmarks, and how their risk-adjusted returns, diversification and investment opportunities compared to their parent cap-weighted indexes.

Connecting Finance and Natural Capital

This guidance is designed to help Financial Institutions take a more integrated systems approach to lending and investment linked to natural capital. FIs need a framework developed for and by the financial sector, to begin getting to grips with what could become an exciting new opportunity or have serious systemic consequences. Sage advice is what this guide provides. It moves through framing, scoping, measurement and valuation, and application of results. It offers case studies by major banks and asset managers, including **ASN Bank** and **BNP Paribas**. The methodology is closely integrated with the Natural Capital Coalition's **'Natural Capital Protocol'** for companies.

Ecosystems Service Trading

Lohmann of the Corner House **outlines** how markets in ecosystem-service tokens (carbon, biodiversity, water quality) have evolved as one component of capital's troubled struggles. Tokens are new global arrangements devised following the collapse of previous compromises.

EU Action Plan for Financing Sustainable Growth

The EC has related an **Action Plan** in response to recommendations from the High Level Expert Group on Sustainable Finance. The EC has committed to a timeline to implement the reforms, with the first legislative proposals to be published in May 2018.

UK Green Finance Taskforce Report

The Accelerating Green Finance report offers a series of recommendations to maintain the UK's position as a world-leading green finance centre, and to deliver the UK's Clean Growth Strategy.

Auditing

High quality audit enhanced by stronger culture

According to a new report by the FRC, **'Audit Culture Thematic Review'**, it is important that firms create a culture where achieving high quality audit is valued and rewarded, and which emphasises the importance of 'doing the right thing' in the public interest. As part of their review the FRC considered how firms identify and pay attention to challenges in their culture and take action to address them to promote and sustain improvements in audit quality.

Abolition of audit obligation for small limited companies-a reform where costs outweigh benefits

The audit obligation for small limited companies was abolished in 2010. **The Swedish National Audit Office's audit** shows that the reform has had few positive effects but has entailed an increased risk of tax evasion and made fighting economic crime more difficult – and therefore the audit obligation should be reintroduced.

Investor Demand for Internal Control Audits of Large U.S. Companies: Evidence from a Regulatory Exemption for M&A Transaction

Carnes (Pennsylvania State University), Christensen (University of Oregon) and Lamoreaux (Arizona State University) **say that** because internal control audits never existed before the passage of the Sarbanes-Oxley Act, and these audits became mandatory for all U.S. accelerated filer companies at the same time, it has been difficult to assess the extent of investor demand for these audits. They find that investors react negatively if a company excludes acquired operations from their internal control audit. This negative reaction is larger when more of the company's operations are excluded from audit and when there is greater information uncertainty. Further, companies that exclude acquired operations from internal control audits are more likely to have a

subsequent restatement. Collectively, these findings are consistent with investors perceiving value in and demanding internal control audits for large U.S. public companies.

Reporting

Sustainable Finance: The accountancy profession's contribution to EU Strategy

The EU's transition to a low-carbon, resource-efficient and sustainable economy has benefits for us all. The financial system has a critical role to play in this process, by ensuring that the economy contributes to long lasting welfare. Professional accountants are crucial in building a comprehensive sustainable financial system. [This publication](#) provides Accountancy Europe's contributions to the European Commission's sustainable finance strategy. They focus on the three areas where accountants can contribute most: corporate reporting to accommodate long-term horizons; disclosure requirements to address investors' needs; and accounting frameworks to be in line with long-term investments.

Long Term Value Creation Through Integrated Reporting

IFAC have issued [FAQs](#) covering: why they see integrated reporting as important; how integrated reporting differs from and relates to other reporting frameworks; what is value in the context of integrated reporting; how integrated reporting fits within the corporate reporting landscape; how a multi-capitals approach can be made more practical helping organisations capture relevant aspects of value creation; whether all organisations can implement integrated reporting; and how professional accountancy organisations can advance integrated reporting.

Financial Services

New rules and consultation on advising on pensions transfers

The FCA has published [new rules and guidance on pension transfer advice](#) and are [seeking views](#) on additional changes, including adviser charging structures, in particular whether they should ban contingent fees for pension transfer advice. The new rules and areas for discussion aim to improve the quality of pension transfer advice to help consumers make informed decisions for their individual circumstances. They have kept the position that an adviser should start from the assumption that a DB pension transfer will be unsuitable.

How Should Financial Regulators Handle the Bitcoin Era?

Magnuson from Texas A&M Law School [report that](#) financial regulators in the US and elsewhere have recently trained their sights on innovations at the intersection of finance and technology. Cryptocurrencies like Bitcoin and Ethereum have come under scrutiny, as have other fintech firms. But despite a flurry of activity and increasing attention to the issue, regulators have struggled to apply old law to new facts.

Capital Markets

Finance for Fintech

TheCityUK and the London Stock Exchange published a [survey](#) which shows that more than a third (35%) of respondents consider raising finance as their top priority, and more than eight in ten (85%) would consider public markets to raise capital. Around the same time the EC adopted an [Action plan on FinTech](#) to enable innovative business models to scale up, support the uptake of new technologies, increase cybersecurity and the integrity of the financial system.

VentureEU

The EC and the European Investment Fund have launched a [Pan-European venture capital fund-of-funds programme](#). The EU will provide cornerstone investment to six funds, managed by selected fund managers, that will take stakes in a number of smaller investee funds and cover projects in at least four European countries each. These investee funds will help finance small and medium-sized enterprises and mid-caps from a range of sectors such as information and communication technologies, digital, life sciences, medical technologies, and resource and energy efficiency.

Tax

Corporate tax avoidance: agreement reached on tax intermediaries

The European Council reached agreement on a proposal aimed at boosting transparency in order to tackle aggressive cross-border tax planning. **The draft directive** is the latest of a number of measures designed to prevent corporate tax avoidance. It will require intermediaries such as tax advisors, accountants and lawyers that design and/or promote tax planning schemes to report schemes that are considered potentially aggressive. The member states will be required to automatically exchange the information they receive through a centralised database. This will enable new risks of tax avoidance to be determined earlier and measures to be taken to block harmful arrangements. Member States will be obliged to impose **penalties** on intermediaries that do not comply with the transparency measures. Member States have until 31 December 2019 to transpose the Directive, and the reporting requirement will apply from 1 July 2020.

Tax-Exempt Lobbying: Corporate Philanthropy as a Tool for Political Influence

Fisman of Boston University **says that** despite Trump's promises to 'drain the swamp' the reality remains that special interests have a great many instruments of influence. In an ironic twist—companies' philanthropic efforts may serve at least in part to influence legislators, presumably to obtain laws and regulations that will serve shareholder interests, rather than the interest of the public.

European Commission-Fair and efficient taxation for the digital economy

The OECD has published its **Interim Report** on tax challenges arising from digitalization, and the EC has also **published proposals** including two draft Directives.

Selected ICAEW CEO blogs since 15 February 2018

12/02/18 - **As Carillion Falls, Questions Arise**

20/02/18 - **Who Can You Trust?**

23/02/18 - **Not a Good Day for the Accountancy Profession**

06/03/18 - **Keeping Up the Good Work**

16/03/18 - **Breaking Up the Big Four**

22/03/18 - **A Transition to Progress**

27/04/18 - **Public responses to Monitoring Group paper will make for better proposals**

Related work across ICAEW

The Oxford Handbook of Corporate Law and Governance

Robert Hodgkinson contributed to the book launch conference held at the Said Business School. He was a panel member for a session concerning convergence and persistence in Corporate Law-Globalisation, Cross-Border Integration (EU) & Disintegration (Brexit).

Another 2,000 members tune into GDPR webinars

Mark Taylor moderated three webinars with commercial partners on practical ways to help members become ready for GDPR. The first webinar was with GDPR Portal a web based application to help track and document GDPR readiness. The second webinar was with Citrix who demonstrated applications to allow organisations to securely share files with clients. The final webinar was with GDPR 365 another web based application to help track GDPR readiness. In total the three webinars attracted some 2,125 registrations, with a total of 778 live listeners. The webinars have been watched on-demand some 419 times.

Whose standards are they anyway?

Tony Bromell submitted the ICAEW response to the Monitoring Group (MG) consultation following initial input from Council, the Technical Strategy Board, Ethics Standards Committee and TPAC and liaison with CCAB, Accountancy Europe, and the GAA. The MG sits at the top of the chain of oversight mechanisms for the audit, ethics and education standard setting boards operated under the IFAC umbrella. We pushed back on proposals which included combining Auditing and Ethics for auditors standard setting into an independently appointed and funded body separate from IFAC. An MG press release indicates that 180 responses were received and that the follow up consultation has now been deferred until the autumn of this year.

Brexit – bringing AE and the UK Government together

The Europe Region arranged for a meeting between Accountancy Europe (AE), BEIS and FRC to discuss Brexit. The objective of this meeting was to increase understanding of the implications of Brexit, particularly for statutory audit. Gareth Davies, Director General for Business and Science at BEIS, and Melanie McLaren, Executive Director at FRC, participated at the meeting. It was chaired by the President of AE and attended by representatives of the largest AE member bodies. The meeting was as positive as it could have been expected given the context of uncertainty with regards to the UK Government's position. ICAEW continues to chair the Accountancy Sub-Group of the PBSC Mutual Market Access Working Group which is the primary channel for dialogue with UK government on the details of the Brexit negotiations.

Making Tax Digital – where to next?

On 21 February Paul Aplin and Anita Monteith attended a roundtable meeting with the Government Minister, Mel Stride, on how the profession can work with Government to ensure that businesses also benefit from Making Tax Digital (MTD). The meeting with the minister had a real sense of shared vision and enthusiasm for digital, but to achieve success businesses need to see some clear benefits from MTD and not just HMRC. With the launch of MTD for VAT registered businesses a little over a year away, it is vital that we keep the dialogue going.

Contact: Anita Monteith

Consultation on the Corporate Governance Code and the Stewardship Code

In our response to this important consultation, ICAEW supported most of the FRC's proposals, but expressed concern in a number of areas including: the expanded remit for remuneration and nomination committees; the role of remuneration committees in relation to the pay of senior managers; the enforcement of the existing clawback and penalty regime; the role of remuneration committees for oversight of workforce policies and procedures; and the role of nomination committees on oversight for a diverse pipeline candidates. We have suggested that the FRC speaks to stewards before removing the exemptions which apply to companies below the FTSE 350. We will also be talking to the FRC about the role of independent assurance to the Stewardship Code.

Faculty reform (governance)

On 14 March, ICAEW Council approved the retirement of the Faculty Constitutions and adoption of new Terms of Reference from 1 January 2019. This action puts the Faculties on a more modern footing to enable them to play their important role in supporting ICAEW strategy as the voice of ICAEW and developing services for members. Attention now turns to refreshing the operating and business models of the Faculties and like governance reform, this is being explored initially through the Faculties Forum. Importantly, this work is being performed alongside ICAEW-wide initiatives such as the digitalisation of technical content, a comprehensive review of ICAEW's communications and critically, a modernisation of business systems. The Faculties will bring a plan to Council later in 2018 for updating the Faculty model for implementation starting in 2019.

Supporting members in adopting GDPR

The combined IT Faculty and Business Law team education programme on GDPR continues across a range of channels. The GDPR hub (icaew.com/gdpr) has been re-launched and a series of four webinars has recently been concluded that addressed practical ways in which members can measure their state of GDPR readiness or make use of technology to operate securely. Recent presentations to members have focused on the need to understand GDPR as a series of principles to be understood and respected. The schedule of GDPR educational work includes privacy notice guidance and advice on engagement clauses. We are working with other professional bodies to approach the ICO for additional clarity on specific member concerns.

Finance for the Future Awards 2018

The Finance for the Future Awards opened for entries on 12 March, to recognise organisations that are embedding sustainability into business decision making, driven by their finance team. Now in its seventh year, a fresh approach has been introduced to the categories as the format evolves. The categories are; innovative project, embedding integrated thinking, sustainable investing and financing, building sustainable financial products, communicating integrated thinking and driving change through education, training and academia. The entry period closed on the 11 May and this year's awards ceremony will take place on Tuesday 16 October.

PCRT – new core document supported by HMRC imminent

ICAEW has been working on a restructuring of the current professional standard on tax, the PCRT, to make it clearer what part of the PCRT is 'mandatory' (ie, which members must follow) and what parts are guidance. Following legal advice, the PCRT will now be split between the mandatory 'Core' PCRT, which will comprise the fundamental principles and standards for tax planning, and the remaining chapters which will be issued as independent help sheets but with links between them and the Core. We expect the core PCRT to be made available to members in a new web-based format at the beginning of April.

Whose standards are they anyway?

Tony Bromell spoke at a Transparency Task Force event entitled 'How can Codes of Conduct positively impact market behaviour? How can the World's capital markets become a force for good?'. The Transparency Task Force is a cross section of individuals, businesses and professional bodies aiming to drive up the levels of transparency in financial services around the world. They have found the work of ICAEW to be exemplary and Tony spoke to them about our approach to ethics and conflicts of interest.

Accountancy Europe

Michael Izza spoke at the Accountancy Europe Members' Assembly, on behalf of all the UK member bodies. He emphasised the importance after Brexit of maintaining the framework between the UK and the EU27 for the profession. Martin Manuzi, as Chair of the Accountancy Sub-Group under the PBSC, presented on the specific implications for statutory audit and potential solutions. Accountancy Europe will consider having a position on this. The implications of Brexit for financial and business services were discussed Kay Swinburne MEP. We exchanged views with an advisor from the European Parliament's Economic and Monetary Affairs Committee on ongoing developments in the tax policy area, including the just-issued proposals for a digital tax. We discussed our work on intergenerational fairness with Ann Mettler, the Director General of the Commission's in-house think tank, who suggested how we might raise the topic on the EU's agenda.