



## PROPOSED REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

Issued 8 March 2018

ICAEW welcomes the opportunity to comment on the *Proposed revisions to the UK Corporate Governance Code* published by the FRC on 5 December 2017, a copy of which is available from this [link](#).

The Corporate Governance Code and Stewardship Code have relevance far beyond companies listed in the UK. Both codes have large and international audiences with varied interests and perspectives. With this consultation the FRC is maintaining its leading position through prioritising outcomes over processes, incorporating culture, and by identifying remuneration and diversity as particular areas of concern. The revised codes will be important milestones in the journey towards restoring trust in business. However, reaching this goal will require sustained efforts by all interested parties. Companies themselves have a particularly important role to play.

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This ICAEW response of 8 March 2018 reflects consultation with the Corporate Governance Committee whose members are drawn from the business and investment communities. The Committee informs our thought leadership and policy work on corporate governance issues and related submissions to regulators and other external bodies.

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## MAJOR POINTS

### CHANGES TO THE UK CORPORATE GOVERNANCE CODE

1. The FRC has taken the right approach by shifting the focus from processes to outcomes. Taken as a whole, these proposals should lead to consistently good outcomes and positive cultures in all companies.
2. ICAEW's thought leadership programme, **Connect and Reflect** complements the FRC's direction of travel. Appreciating the importance of perceptions and striving for the best possible outcomes are key to companies connecting with stakeholders and reflecting on the feedback received. We are keen to share our work with the FRC, and we are also happy to follow-up on any points in this submission.
3. We support greater emphasis on stakeholder engagement, especially engagement with the workforce as this is critical to culture. The workforce are an informed and accessible audience which should be used to test boards' explanations for their actions, aspirations and constraints, eg, in relation to executive remuneration. Tone from the top is only one part of the picture. The right values must permeate throughout a company for them to have the desired effect. We do not underestimate the challenges companies will face as they operationalise workforce engagement and that is why we have made suggestions for additional guidance which would benefit everybody who will play a part in this process. We are also developing a paper on how employee directors add value as part of our Connect and Reflect programme.
4. The UN Sustainable Development Goals (SDGs) should be recognised in the Corporate Governance Code (the Code) as this will help companies to demonstrate that they can and do respond to changes in societal expectations.
5. We support most of the FRC's proposals on remuneration, although in our view remuneration committees should only focus their attention on directors' remuneration, and clawback/malus deserve closer consideration.
6. Improving diversity on boards and in senior management would be another important demonstration of companies responding to societal expectations as well as recognising the value that diversity brings to companies. We have made suggestions which we believe would support this objective, eg, we support reporting on all forms of diversity, and the nomination committee's expanded remit for diversity in the pipeline needs to be more clearly defined.
7. Diversity is one of the reasons why we support the strengthening of a presumed nine years maximum for board chairmen, although we are pleased to see that it will still be possible to for a chairman to serve longer if this can be explained, albeit in exceptional circumstances.
8. The exemptions for companies below the FTSE 350 should only be removed if the FRC receives reassurances that explanations will receive due consideration. We have suggested that there is a deeper analysis around this as part of a broader review of the risks, costs and benefits of removing exemptions.

## FUTURE DIRECTION OF THE UK STEWARDSHIP CODE

9. The Code and the Stewardship Code are often referred to as two sides of the same coin. In our view this should remain the case and the FRC should concentrate on changes to the Stewardship Code which will enhance the synergy between the two codes. The need to address existing challenges must not be overshadowed by taking the Stewardship Code into areas which are outside of the FRC's remit. If there are internal governance failings at investment firms they should be addressed by the relevant regulators.
10. The FRC should consider whether stewards give companies' explanations due consideration as the concept of comply or explain may be threatened unless this is properly addressed. Notwithstanding Brexit, the FRC also needs to fully consider the implications of the EU Shareholder Rights Directive<sup>1</sup> (the Directive). The Directive must be reflected in the Revised Stewardship Code when it is published later this year. The approach to stewardship taken by tracked funds also needs to be better understood and, if necessary, addressed.

## RESPONSES TO SPECIFIC QUESTIONS

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

11. Yes. The proposal for the revised Code to apply to accounting periods beginning on or after 1 January 2019 is too soon and should be delayed.
12. Principle C and Provision 4 concern shareholder and stakeholder engagement. This is closely connected to pending secondary legislation announced by the Department for Business, Energy & Industrial Strategy (BEIS). In future all companies of a significant size (private as well as public) will report on how their directors comply with s172. BEIS are considering applying this requirement to companies with over 1,000 employees, but this threshold will be subject to consultation.
13. There are similarities and differences between Strategic Reports and this new report. Different companies are in scope, and members are the only audience for Strategic Reports whereas the audience for the new report is intended to be much broader. The new report places greater emphasis on how directors have fulfilled their duties. Reports may include how the company has identified and sought the views of key stakeholders, why the mechanisms adopted for stakeholder engagement are appropriate, and how the engagement has influenced decision-making in the board room, ie, the outcome as well as the process. However, it is too soon to predict the exact contents of the new report as this will also be subject to consultation.
14. The FRC has acknowledged that the Code section on remuneration may need to be changed to reflect forthcoming secondary legislation on pay ratios and complex share-based incentive schemes.
15. The original intended timetable for this secondary legislation was for it to be laid before Parliament before March 2018, and to be brought into effect by June 2018, to apply to company reporting years on or after that date. This timetable has not been met and we are unaware of a commitment to a revised timetable. There is such strong cross-over between the new law and several areas of the Code that the FRC cannot complete its

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<sup>1</sup> 2017/828

review in advance.

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

16. One of the most powerful statements in the Guidance is the simple observation that the boardroom should not necessarily be a comfortable place. Although this should be self-evident it is still a point worth making.
17. There is a widespread problem of boilerplate language in reporting, and its use seems to be undermining the option to explain. The FRC must address this issue head-on through guidance on bad practice, building on Figure Two of the Guidance.
18. As we explain in our response to Q3, the Guidance has a particularly important function in relation to workforce directors. The Guidance should make clear that all directors need to consider the views of the workforce even if a fellow director takes the lead in this area, eg, a designated NED or a workforce director. It is helpful that paragraph 68 of the Guidance makes references to NEDs meeting the workforce and the need for all directors to take account of different perspectives.

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

19. Section 172 of the Companies Act (2006) (s172) articulates directors' personal responsibilities. Companies can take legal action against individual directors for breaching s172, eg, a derivative action taken on behalf of shareholders.
20. Principle C enhances the significance of s172 through its adaptation into an entity reporting obligation linked with the Listing Rules. This adaptation from a personal obligation to a company reporting requirement is not new for companies who must prepare Strategic Reports. However, it will be new for overseas companies listed in the UK. In effect Principle C will give s172 extra-territorial effect, the difference being that only directors of UK companies can be sued.
21. The Guidance refers to boards identifying their different sets of stakeholders. Companies should report: which stakeholders they think are relevant and irrelevant to them and why; how they have defined stakeholders such as 'community' and 'environment'; and how competing priorities of different stakeholders will be assessed and managed. Companies should then detail their process of engagement with their chosen stakeholders and outline the outcomes this has achieved, eg, the gathering of support for a board proposal or suggestions around effective implementation of a change programme.
22. Meaningful engagement requires companies, management and the workforce to embrace the spirit of Provision 3, and that includes engagement with any workforce who are based overseas. The FRC can help by acting as a repository for best practice examples as they become available. Companies should have to report on how workforce engagement changed a decision or outcome, not just on which of the three options (or more) they have chosen from Provision 3. For this reason it would be better if Provision 4 referred to outcomes as well as, or instead of, influence, and the reference to integrity in Principle D should be moved elsewhere in order to avoid any unnecessary confusion.
23. Workforce directors and designated NEDs could benefit from a formal workforce advisory panel as a conduit for information and feedback. Similarly, in order to avoid panels becoming isolated talking shops they will need a bridge to the board. Written

communications between panels and boards may work in some instances but not in all. The advantages of combining the options in Provision 3 is briefly mentioned in the Guidance but this could be expanded to say that the voluntary adoption of multiple options demonstrates an understanding that the ultimate objective is effective outcomes not box-ticking.

### Workforce Director

24. We are concerned that companies will not choose this option unless the FRC provides additional guidance about how to overcome the more difficult legal and practical challenges, eg, commercial confidentiality, how to select one or more workforce directors from a large multisite or multinational workforce, how elections of directors by the workforce relate to the annual election of directors (Provision 18), any implications for unitary boards, and how workforce directors should balance their general legal duties with their specific duty to give the workforce's perspective.
25. The appointment of a workforce director will necessitate support mechanisms which the Code or Guidance should explore. Board chairs, other directors and the workforce director themselves will have overlapping and specific training needs. The following would consolidate and clarify the role and position of workforce directors:
- a) Provision 3 should refer to current workforce and define it, but there must be no geographical limits;
  - b) the Guidance should clarify the position of workforce directors who do not have employment contracts;
  - b) Section 2: Division of Responsibilities should define workforce directors as executive or non-executive, or create a new categorisation. The role of workforce directors on committees should also be clarified;
  - c) Principle E says that, in particular, the chair should ensure the effective contribution of all non-executive directors. The effective contribution of workforce directors should be added here, and this addition should be linked with the references to culture, openness and debate;
  - d) Provision 11 refers to the chair holding separate meetings with NEDs. We suggest that workforce directors also have separate meetings with the chair;<sup>2</sup>
  - e) consideration should also be given to assigning special responsibility for mentoring the workforce director to the senior independent director (SID)<sup>3</sup> ;
  - f) company secretaries could also play an important role in assisting workforce directors with assimilating the information provided to boards, and helping workforce directors understand the relationship between committees and the board;
  - g) workforce directors should have access to appropriate training. Paragraph 70 of the Guidance refers to updating directors' knowledge in a manner that is appropriate to the particular director. The needs of workforce directors could be given as an example of specific training needs; and
  - h) the Guidance splits responsibility for directors' training among the chair, CEO and company secretary. We are concerned that by making a number of people responsible, ultimately nobody will be held responsible. We suggest that one individual is identified, and as workforce directors may be reticent about discussing

<sup>2</sup> It should be made clear in the Guidance that these meetings are for any general concerns the workforce director may have. All workforce issues which fall under the board's remit must be discussed collectively.

<sup>3</sup> Failure to integrate a workforce director could be a stress mentioned in paragraph 58 of the Guidance so that it triggers SID 's to intervene to maintain board and company stability.

their training needs with the CEO or chair we suggest that the responsible person is the company secretary.

## NED

26. We recognise that allocating specific responsibilities to a Non-Executive Director (NED) follows the approach taken in financial services, eg, the Whistleblowers' Champion. For the role to be meaningful the FRC must provide guidance on how designated NEDs should balance this specific responsibility with their general responsibilities as a company director. We want to avoid a situation where NEDs are reluctant to take on the role, eg, because it is viewed as onerous, thankless or perfunctory box-ticking.
27. There are practical questions around: how designated NEDs should communicate with the workforce, including frequency and method of contact; what the workforce can expect and how to manage everybody's expectations; how board meetings should be managed so that the workforce perspective is allocated sufficient time and weight; and how designated NEDs should provide feedback to the workforce and to the board. Perhaps most importantly, designated NEDs and their boards need to understand that the role is to feedback regardless of whether or not the NED agrees with the workforce's opinions. We have mentioned use of multiple mechanisms and the complementary role of panels in paragraph 23 of this response.

## Workforce Advisory Panel

28. Again, guidance is need as to who and how panel members are selected, the rotation of members, who should chair the panel, their link with the board, etc.

## Whistleblowing

29. Principle D and the second half of Provision 3 concern whistleblowing. As whistleblowing differs from routine employee engagement it should be covered in a separate provision. The Code must also be clear that anybody can blow the whistle or 'speak up.'
30. We support the transfer of direct responsibility for whistleblowing to the board. We also support the widening of the current definition of whistleblowing, although some limitation should be applied in order to avoid trivial matters being reported using this route, eg, routine HR matters, minor health and safety breaches, etc.
31. What makes an investigation independent and the nature of the required follow-up action also need to be explained eg, for whistleblowing which has no merit the follow-up may be limited to: ensuring all necessary procedural steps are followed (which may include an ability for the whistleblower or the accused person to appeal); reporting the finding to the parties and the board; and closing the file. On the other hand, where whistleblowing has exposed serious wrongdoing or cultural problems then significant follow-up will be needed under the direction of the board.
32. The frequency of whistleblowing and/or speaking up is an additional source of cultural insight which should be added to page 8 of the Guidance. However, the board should only be provided with anonymised statistics. The identities of individual whistleblowers must not be disclosed unless they have agreed to waive confidentiality or anonymity.

## **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?**

33. The SDGs are an intergovernmental agreement not NGO principles. UN Member States are responsible for achieving the SDGs by 2030 and their progress is measured with

reference to targets and indicators. The FRC may wish to liaise with the Office of National Statistics who are developing the UK's approach to SDG reporting.

34. Principle A refers to companies' contribution to wider society. We suggest an associated provision which encourages companies to review what they can do to help achieve the SDGs.
35. We believe that any company should be able to identify one or more SDGs which are relevant to them. For many companies sustainable consumption and production patterns (SDG12) will be relevant. Target 12.6 concerns large and transnational companies adopting sustainable practices and integrating sustainability into their reporting cycles. Member States will be measured with reference to indicator 12.6.1 which is the number of companies publishing sustainability reports. We are unclear if indicator 12.6.1 refers to the number of companies operating in the country and/or incorporated in the country. When considering this issue the FRC should bear in mind that many foreign companies with a UK premium listing are in the energy and natural resources sectors where sustainability reporting is particularly important. Although these companies are listed in the UK, they operate overseas.
36. Dependent on their sector, other companies may chose alternative or additional SDGs: decent work and economic growth (SDG 8); good health and well-being (SDG 3); clean water and sanitation (SDG 6), quality education (SDG 4), etc.
37. As progress with the SDGs will be measured by UN Member States their achievement must also be measurable by companies. We suggest that SDG targets set by companies themselves are linked with directors' performance-related remuneration in Principle P.
38. If the SDGs are added to the Code then the language used must not be confused with either the economic sustainability or the sustainable success of companies.

***Question 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?***

39. This consultation has been superseded by the launch of the Investment Association's public register of opposition votes of 20% or more. This low threshold reinforces the power of proxy advisors, does not cater for abstentions, is out of line with other recent legal developments<sup>4</sup>, and in effect it has created a requirement for a supermajority. However, these considerations are outweighed by the greater advantages of the Code using the same threshold as the Investment Association's register.
40. We also support six-monthly updates covering both shareholder consultations which have already taken place and planned future consultations. This will complement the announcements made when results are first announced. Interim updates will help to keep minds focused. For the reasons outlined in paragraph 22 of this response, it would be better if Provision 6 referred to outcomes as well as, or instead of, impact.

***Question 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? If not, please provide information relating to the potential costs and other burdens involved.***

41. Although this question is limited to the application of board evaluations to companies

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<sup>4</sup> The register of People with Significant Control of UK companies.

below the FTSE 350 we trust that the FRC is open to feedback on any of the changes being proposed for these companies, ie, the annual election of directors, and the increase in the number of independent NEDs needed for boards, audit committees and remuneration committees.

42. The FRC should take a number of steps before removing these exemptions. Firstly the FRC should ask investors and proxy agents what position they will adopt if smaller companies chose to explain rather than comply in the relevant areas. Secondly the FRC should publish an Impact Assessment which examines each exemption separately, eg, increasing the number of independent NEDs on audit committee may be as costly as the introduction of board evaluations, although these costs may be outweighed by diversity gains. Another advantage of removing the exemptions would be implicit support of comply or explain as an effective mechanism which is as relevant to the future as it is to the past.

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

43. The FRC should take this opportunity to remove the confusion caused by the Code's dual use of the term independence. This term is used in the general sense in the context of chairs' objective judgement (Principle E) and the composition of boards and committees (Principle I). This is easily confused with 'independence' as specifically defined in the Code (Provision 15).
44. In order to avoid confusion we suggest that independence is no longer referred to in the general sense and that objectivity is referred to instead. A clear distinction is particularly important in the light of the FRC's proposal to require chairs to be independent throughout their tenure. If, in this context, independence is as defined in Provision 15, then we support this change. We must caveat our support in this way because chairs inevitably lose their initial independence in the general sense because of the close working relationships they must form with executive directors and senior management.
45. The central point that board chairs should not be over-committed, either to internal committees or because of external appointments, should be included in Principle E. In fact this capacity point is not limited to board chairs. As the remits of both the remuneration and nomination committees have grown, so have the time implications for both the chairs and members of these committees.
46. Current Provision D.1.2 says that the remuneration report should include a statement as to whether or not an executive director who is released to serve as a NED will retain earnings and, if so, what the remuneration is. This provision should be repeated in the new Code.
47. The FRC may wish to take this opportunity to revisit why a board chairman can or cannot belong to or chair the audit, remuneration and nomination committees. Independence should no longer be a condition for their membership of the remuneration committee given that a chairman will now be presumed to be independent throughout their tenure.
48. Nine years is a historical period developed when directors were elected every three years (as they currently are, and may continue to be, in companies below the FTSE 350). We are unable to provide a convincing argument to support an alternative period.



As far we are aware nine years is generally accepted and it is functioning well.

49. The proposed revisions to the Code tighten the rules for independence of chairs by reversing the burden of proof, but the option to explain a deviation from the criteria remains possible. Acceptable explanations for an independent NED or chairman to exceed nine years may include a desire to retain diversity. Acceptable explanations for a chairman to exceed nine years may arise, eg, because an independent NED who has been promoted should be allowed a full nine years as chairman, to avoid a temporary interim chair appointment, to oversee ongoing director rotation, or because of an exceptional and unforeseeable crisis that only the existing chair can be reasonably expected to deal with.
50. Another potential objection to nine years is loss of institutional memory, but reliance on specific individuals is dangerous and it is a problem which only gets worse with time. Institutional memory should be enshrined in minutes, and to some extent, in the office of the company secretary. If the Institute of Chartered Secretaries & Administrators (ICSA) can be persuaded to make their guidance on minute-taking publicly available then this would be a helpful footnote to Provision 8 and to the third bullet point of paragraph 20 of the Guidance.
51. We suggest that Provision 14 requires transparency of cross-directorships because of the implications for a lack of challenge in boardrooms and for slowing progress on diversity.
52. Conflicts of interest are dealt with in Provisions 7 and 15. At the moment the only example provided is significant shareholdings. The FRC should consider providing more examples, eg, the third parties referred to in Provision 15 could be identified.

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

53. The revisions being made to the Code come fairly close to imposing a nine year maximum tenure for all independent directors, but especially for board chairman, albeit that it should be possible to explain a short extension, eg, in the circumstances set out in paragraph 49 of this response.
54. Annual re-elections and the need to justify directors' contributions, covered by Provision 18, make a maximum period of tenure unnecessary provided that:
  - (a) the Code is clear that swaps from independent to non-independent status will rarely be justifiable, particularly a swap from chair to NED as this may undermine the authority of the new chair;
  - (b) current Provision B.2.3 is retained, ie, any term beyond six years for NEDs should continue to be subject to particularly rigorous review, and should take into account the need for progressive refreshment of the board; and
  - (c) section 3 on board composition should refer to the advantages of a good balance between experienced and newly appointed directors.

**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?**

55. Principle J correctly defines diversity very broadly. Richness of contribution and cognitive diversity are vital and these concepts have been captured in the suggested wording.

56. The Guidance should point out that:
- a) board diversity is not an end in itself or a nice to have. It is the required infrastructure for Principle C. Engaging and participating with a diverse range of stakeholders will not be effective unless the board itself is diverse; and
  - b) appointing a director from the workforce is a good way to improve board diversity.
57. We agree that the nomination committee should have oversight of a diverse pipeline but the question is how far down in the company their oversight should extend. The Code refers to succession to the board and senior management. This implies that nomination committees' focus should just be on one or two levels below that, ie, on those about to step up to the board or senior management. On the other hand Q9 also refers to diversity in the company as a whole. The FRC should compromise between these two extremes by expecting nomination committees to oversee the diversity of the top half of the company. This would have the advantages of reflecting the importance of tone in the middle, extend succession considerations beyond immediate succession to mid-term succession, but at the same time it would avoid overloading the committee.
58. The new oversight responsibility for the diversity of the pipeline is one of the reasons why we suggest that chairs of nomination committees must also have twelve months' experience. See paragraph 70(b) of this response for the reasons why we agree with the FRC's proposal that experience gained with any nomination committee should count.
59. A footnote referring to the [standard](#) and [enhanced](#) codes of conduct for executive search firms could be attached to Provision 20 as both cover gender diversity. This footnote could also suggest that companies instruct their search firms to include applicants' commitment and understanding of a company's values and culture as sifting criteria.
60. The complete removal of directors' insurance for legal action, and the removal of access to independent advice and training from the Code, works against the FRC's diversity aims<sup>5</sup>. Those who are taking on a director role for the first time would have found these safeguards reassuring.

**Question 10: 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.**

61. Yes. All companies subject to the Code should be required to report the gender balance of their senior management and their direct reports. In fact diversity reporting should go further as outlined in paragraphs 62-64 of this response. The FRC's Impact Assessment referred to in paragraph 42 of this response does not need to explore this issue.

**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.**

62. There is an inconsistency between the wide definition of diversity in Principle I and Principle J (which is cross referenced in the second bullet point of Provision 23) and the limitation in the fifth bullet point of Provision 23 to reporting on gender only. Companies

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<sup>5</sup> See paragraph 25 (g) and (h) for our thoughts on the training needs of workforce directors.

should report on all forms of diversity. Ethnicity is sensitive personal data, but if the Code is categorised as a regulatory instrument then compliance with it is exempt. In any event, any legal issues can be avoided by anonymising information.

63. Reporting on gender and on other forms of diversity should also apply to board members. Information on current board composition is the benchmark for assessing whether the initiatives taken in the Code have made a difference. It is clear from the statistics included in the Hampton-Alexander Review and in the Parker Review that the gender and ethnicity of boards is information which is either already available or which is easy to obtain. Companies often publicise who sits on their board on their web site and elsewhere.
64. The Guidance should also give serious consideration to encouraging reporting on the nature of pre-university schooling. This is the best measure that we are aware of for assessing social background.

***Question 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 or Companies Act?***

65. The Listing Rules require companies to report on the Principles in a manner that shareholders can understand. The revision of the Code presents an opportunity to try and extend this audience, eg, company reporting on the SDGs may be of interest to the the public, non-governmental organisations (NGOs), international NGOs and governments.
66. There are overlaps between the Financial Conduct Authority's (FCA) rules and the Code's coverage of audit, risk and internal control. The question is whether removing this section from the Code would helpfully draw attention to other areas of the Code or confuse matters. On balance, we suggest that all sections are retained as they are complementary.

***Question 13: 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.***

67. Terms of Reference (TOR) are always helpful and they are not onerous. The TOR for audit committees will change as a result of responsibility for whistleblowing swapping to the board.
68. We suggest that paragraph 12 of the Guidance clarifies that the board's TOR must be available from a publicly accessible web page, and that paragraph 53 applies the same approach to the TOR for all board committees.

***Question 14: 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?***

69. We agree that the remuneration committee should have oversight of the whole of a company's remuneration as this will place their consideration of strategic rationale for executive pay in a broader context. However, the impact of this change should not be exaggerated as the current code requires remuneration committees to be sensitive to pay and conditions elsewhere in the group.
70. Remuneration is a specialist and absorbing area of work, and for this reason:
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- (a) we disagree with giving remuneration committees a new responsibility for other policies and practices (Provision 33 and paragraph 103 of the Guidance); and
- (b) we agree that chairs of remuneration committees need twelve months' experience. In fact we would expect twelve months to be the minimum period. We also agree that experience with any remuneration committee should count. Having said this, in most circumstances the advantages of company-specific knowledge will outweigh the advantages of a completely fresh external appointment to the role of chair, but not in all.

71. We feel strongly that responsibility for setting the pay of senior management must not be transferred to the remuneration committee. The FRC has not provided a reason for this proposal. If pay is simply seen as too high then we doubt whether this proposal will have the desired effect, especially as remuneration committees' use of advisors is widespread.

72. The two existing systems for remuneration are:

- (a) recruitment, retention and remuneration are the CEO's responsibility. Her or his performance in this area, and in all other areas, is overseen by the board; and
- (b) executive directors' pay requires different governance arrangements involving board responsibility (albeit the remuneration committee make recommendations to the board), and, importantly, external shareholder scrutiny through the say-on-pay regulations.

73. The proposal for the remuneration committee to set the pay of senior management would create a hybrid of these two systems. Remuneration committees would make additional recommendations to the board, but the board's decision would blur the CEO's responsibility and it would not be subject to external shareholder scrutiny.

***Question 15: Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?***

74. Provision 36 should be clear that the total period, covering both vesting and post-vesting holding, is five years. There should not be any prescription as to how these five years are apportioned between vesting and holding periods. A presumed apportionment of fixed pay versus variable pay could be added to Provision 36, which would operate on a comply or explain basis.

75. The FRC will appreciate that extending the vesting and holding period for LTIPs from three to five years is likely to increase the tenure of executives, and make it more common for new employers to have to compensate executives for financial losses incurred by moving. This may have positive and negative effects.

76. Given the rarity of clawback/malus it is insufficient to simply repeat Provision 37 in the new Code. The FRC should develop guidance on how these contractual terms can be used, and give examples of circumstances when they must or should be used. Paragraph 111 of the Guidance refers to erroneous or misleading data, misconduct and misstatement of accounts. This is a start but this subject needs development. Best practice on clawback/malus may be available from other countries. If clawback/malus remain inoperable in the UK then consideration should be given to reducing the one year notice period in Provision 39.

77. We did consider linking performance-related remuneration with culture in Principle P, but

because of the difficulties of how to measure culture we decided against this. Instead we suggest that Questions for boards on page 8 of the Guidance challenge boards to question whether their directors' remuneration is aligned with company values.

78. We support consistency of tax policy with values. This is a valid and important question for boards to ask management.

**Question 16: Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?**

79. Boards already have independent discretion, and it can lead to increases as well as decreases in remuneration.

**Question 17: Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?**

80. The continued success of 'comply or explain' relies upon investors and their advisors accepting valid, well-articulated and reasonable explanations. At the moment there is an expectation that proxy advisors will advise their investor clients not to accept explanations and that investors blindly follow advice, eg, extended tenure for company directors is routinely opposed. These practices or perceived practices need to change and the FRC has an important role to play here.
81. The introduction to the Code refers to shareholders and their advisers paying due regard to companies' individual circumstances and the need for explanations to not be evaluated in a mechanistic way. This sentiment must also feature in the Stewardship Code. We suggest that revised Principle 1 encourages investors to seriously consider explanations and allow companies sufficient time to respond to their enquiries. The FRC could consider a new principle which requires investors to develop and publish a policy on their approach to explanations.
82. The number and range of investors subject to the Stewardship Code will balloon with the implementation of the Directive which will led to greater specificity in some areas, eg, Article 9c of the Directive concerns related-party transactions. Principle 2 will need to be amended so that: shareholders must approve related-party transactions; and other related-party transactions must be disclosed at the time of their conclusion alongside a third party assessment of fairness, eg, fairness towards minority shareholders. The Directive also requires dissuasive and proportionate penalties, but natural justice requires expectations to be clear before sanctions can be applied.
83. In terms of overall structure, we suggest the retention of a core code, but with tailored sector-specific guidance covering different parts of the investment chain. The FRC should also consider the approach to stewardship taken by tracked funds.

**Question 18: Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?**

84. Comply or explain are meant to be equal options for provisions. Expectations fall into a separate category from provisions, and as we have explained in paragraph 82 of this response, implementation of the Directive may lead to some parts of the Stewardship Code being recast as expectations or as compulsory requirements. On the other hand,

unless the UK wishes to gold-plate the Directive, other elements of the Stewardship Code must remain comply or explain, eg, Article 3f of the Directive (engagement policy) and Article 3g (investment strategy of institutional investors and arrangements with asset managers) are both comply or explain.

**Question 19: Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?**

85. As the Directive requires dissuasive and proportionate penalties, the FRC needs to give consideration to sanctions as well as best practice. The removal of Tier 3 was a positive step, even though a number of signatories had already voluntarily withdrawn.
86. In June 2023 Member States will be required to report to the European Parliament and Council on their implementation of the Directive and on its effectiveness. The FRC should keep a watching brief as this feedback could help to inform the FRC's general approach.

**Question 20: Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?**

87. The FRC's focus on outcomes for the Corporate Governance Code should be mirrored in the Stewardship Code. The Stewardship Code should require investors to report what their engagement has achieved as well as how it was done. The Stewardship Code could mirror the fourth bullet point of Provision 41 of the Corporate Governance Code which refers to the impact (or outcome) of shareholder engagement.

**Question 21: How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?**

88. Boards, and the individual directors who belong to boards, are collectively and individually responsible for long-term success. Investors cannot and should not be given a greater role in this area as this could confuse or impede the routes of legal action for enforcing s172 against individual directors.

**Question 22: Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?**

89. No. The FRC should not give any aspect of the Corporate Governance Code special status. Investors should consider all aspects of the Corporate Governance Code and the FRC's focus should be on how they exercise stewardship.

**Question 23: How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?**

90. Article 3g of the Directive concerns investors and asset managers publicly disclosing their engagement with investee companies. We are unclear as to whether this means disclosure of a general policy, which is already dealt with in Principle 1, or whether it is intended to cover disclosure of company-specific engagement.
91. The question of encouragements which fall outside of the Stewardship Code highlights the uncertain status of FRC guidance which is non-mandatory, non-prescriptive and not

cross-referenced in a core code. The FRC should clarify whether the purpose of its Guidance is just to stimulate thinking or something more than that.

**Question 24: How could the Stewardship Code take account of some investors' wider view of responsible investment?**

92. We are uncertain if the FRC views creditors as investors, but if it does it should acknowledge that creditors will view their responsibilities and needs in different ways, eg, concerns about share buybacks. The FRC will be aware that BEIS has announced [research on share buybacks](#) and this may recommend disclosure requirements which either apply to investors and creditors or which are relevant to them.

**Question 25: Are there elements of international stewardship codes that should be included in the Stewardship Code?**

93. National codes can and should cater for country specific issues, eg, it is appropriate for the UK's Corporate Governance Code to focus on remuneration but this may be unnecessary in other countries. We do not see a pressing need to amend the UK Stewardship Code to address the international issues identified in paragraph 29 of the consultation paper.

**Question 26: What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?**

94. Through its Audit and Assurance Faculty, ICAEW has led thinking and practice on the role of independent assurance in relation to the Stewardship Code. We have requested a meeting with the FRC to discuss this issue and how we could contribute to the future development of the Stewardship Code.

**Question 27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?**

95. Directed voting, otherwise known as advance voting instructions, relates to the relationship which stewards have with their clients. In our view, this should fall outside the ambit of the FRC and the Stewardship Code. It is an issue which is best approached bilaterally or by the FCA.

**Question 28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?**

96. No. The FRC should not give any aspect of the Corporate Governance Code special status. Investors should consider all aspects of the Corporate Governance Code and the FRC's focus should be on how they exercise stewardship.

**Question 29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?**

97. No. The FRC should not give any aspect of the Corporate Governance Code special status. Investors should consider all aspects of the Corporate Governance Code and the FRC's focus should be on how they exercise stewardship.

**Question 30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?**

98. The FRC can and should provide a broad high-level definition of the purpose of stewardship and more nuanced interpretations which are applicable to different parts of the investment chain, perhaps in the tailored guidance referred to in paragraph 83 of this response.

***Question 31: Should the Stewardship Code require asset managers to disclose a fund’s purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?***

99. If asset owners require better disclosures and more transparency from asset managers at fund level then this must be resolved bilaterally or by the FCA.