



## THE WATES CORPORATE GOVERNANCE PRINCIPLES FOR LARGE PRIVATE COMPANIES

Issued 17 September 2018

ICAEW welcomes the opportunity to comment on the Wates Corporate Governance Principles for Large Private Companies published by Financial Reporting Council on 13 June 2018, a copy of which is available from this [link](#).

The Wates Principles are formal recognition that governance standards are required for large private companies, and they provide a starting point for deeper consideration of this issue at a later date. However, as they stand, the Wates Principles do not reflect the diversity of private companies and they will have little or no impact on restoring public confidence. Unfortunately the Wates Principles may even have the unintended consequence of reducing governance standards in the large companies which currently use the Corporate Governance Code as their benchmark, with appropriate adaptations.

This ICAEW response of 17 September 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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## KEY POINTS

1. The Government's response to the BEIS Green Paper consultation expressed an intention for the UK's largest privately-held businesses<sup>1</sup> to meet higher minimum corporate governance and reporting standards. The Wates Principles do not fulfil this commitment. The point that large private companies can have the same impact as public companies has been lost, the hoped for benefits of an increase in international reputation will not be enjoyed, the public and investors will not be reassured and the trend of delisting by public companies will not be reduced.
2. Respondents to the Green Paper consultation took the opportunity to reiterate that the social and economic impact of large private companies can be as great as that of listed companies. Failure poses similar risks for pensioners, employees, supply chains, local communities and others. In fact the impact of failure can be greater for external stakeholders than for owners. This is reflected in the coalition's objectives, as set out in their Terms of Reference, which are to: improve public trust and confidence through greater transparency; promote strong corporate culture and integrity; encourage broader consideration of the workforce and wider stakeholder interests and representation to drive sustainable outcomes; increase in confidence and long-term value; and improve productivity.
3. These ambitious objectives should have encouraged the coalition to use the Corporate Governance Code (CGC) as their starting point for the design of bespoke principles for large private companies. This approach would have changed the process because exclusions would have needed to be justified. As indicated by the Select Committee and others, the application of the CGC in its entirety is not appropriate, but using the CGC as the starting point would have resulted in higher and more appropriate expectations for large private companies.
4. The Government's response to the BEIS Green Paper referred to similar standards [to those which apply to public companies] applying to large privately-held businesses. For example, the Government expected the new principles for private companies to include the CGC principle concerning strengthening the voice of employees and other non-shareholder interests at board level.<sup>2</sup> The finalised Wates Principles must either make this addition, or the accompanying feedback statement must explain the reason why the Government has changed its mind on this important point.
5. Sir John Kingman's review of the FRC has raised timely and pertinent questions about whether the UK's approach to corporate governance is fit for purpose, both now and for the future. We have encouraged Sir John to consider whether compliance should be monitored. The Select Committee referred to the establishment of a new body to oversee and report on compliance with a new code for private companies, with an associated complaints mechanism, funded by code signatories.
6. In our view the Wates Principles are a placeholder pending changes to the broader landscape. This may mean that the Wates Principles are revised sooner than was originally intended. The development of a long-term and credible approach for private companies requires a new chairman and executive sounding board, and a refreshed coalition which reflects the spirit of Wates Principle Two. The right balance of skills, backgrounds experience and knowledge requires an equal proportion of business representatives and representatives from stakeholder groups, eg, consumer bodies and employee associations.

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<sup>1</sup> Defined by the Companies (Miscellaneous Reporting Regulations) (2018) as companies (including subsidiaries) which satisfy either or both of the following conditions-

- (i) It has more than 2000 employees globally;
- (ii) It has-
  - (a) A turnover of more than £200 million globally, and
  - (b) A balance sheet total of more than £2 billion globally.

<sup>2</sup> See paragraph 2.44 and Action Point 7 of the Government's response to the BEIS Green Paper consultation, and Principle One, Provision Five, of the CGC..

## ANSWERS TO SPECIFIC QUESTIONS

### ***Question 1: Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?***

No the key issues are not addressed, eg. Principle Two must focus on directors' capabilities as well as their capacity, and whistleblowing is another significant gap. The omissions stem from both the disregard of the CGC, and because audience of all private companies is too wide. Although the consultation paper acknowledges that one size does not fit all, the coalition have fallen into this trap.

The coalition should have limited themselves to their Terms of Reference, project purpose, which was to developing corporate governance principles to promote best practice corporate governance within large privately-owned companies in the UK. The coalition's decision to design principles which are applicable to all private companies has resulted in an excessively light-touch for large private companies.

The heterogeneity of private companies is mentioned on a number of occasions. Our solution is that private companies are categorised. A phased application will counter the risks of inflexible prescription and encourage voluntary application. It will also be more effective in delivering the coalition's objectives and purpose, and the outcomes which the Government and public expect.

Categorisation of private companies will allow a tiered approach to the application of principles, ie, some basic or core principles could be applied to all private companies, with a gradually increasing number of stretching principles being applied to companies dependent on their size, complexity and risk level. Large companies will be subject to the highest expectations, ie, a modified version of the CGC. This approach reflects the balance achieved for public companies, ie, uniform application of CGC principles, but flexible application of CGC provisions achieved through 'comply or explain.'

This approach would have the added advantage of allowing the nuances of different companies to be properly reflected. For example, the Term of Reference, project scope, refers to clear division of responsibilities at a senior level and within the wider company, to effectively manage risk, including the concentration of decision-making powers. This point isn't adequately covered by Wates Principle Three, and this may be because it is not be appropriate for all sole, family or employee owned companies to be expected or required to separate the role of CEO and chairman. These companies may also need a tailored approach for succession planning and rotation. Private companies which aspire to a public listing within a set timeframe may also need special treatment.

### ***Question 2: Are there any areas in which the Principles need to be more specific?***

Greater specificity would benefit both the companies which are attempting to comply, and stakeholders who are the intended beneficiaries. However, this specificity can only be achieved by recognising the diversity of private companies by using tiered approach we have referred to in Q1.

### ***Question 3: Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?***

Too much account has been taken of these variations, and that has resulted in principles which are bland, business-as-usual and distilled to the lowest common denominator. The tiering we have described in Q1 is the right way to recognise the variation of private companies and set appropriate standards.

### ***Question 4: Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken [into] account in setting directors' remuneration?***

Remuneration is probably the more important area which needs to be covered because of the impact on trust in business. Provision 39 of the CGC covers length of notice and contract periods and these areas may be appropriate for large private companies but not all private companies.

**Question 5: Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?**

The Government expected the principles to cover representation of stakeholders in the boardroom in the same way as the CGC Principle One, Provision Five.

**Question 6: Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?**

Making a fair, balanced and understandable assessment of the company's position and prospects available to material stakeholders on an annual basis should be an expectation for large private companies.

The guidance to Wates Principles Six should refer to companies responding to stakeholders enquiries arising from these assessments and from supporting statements.

**Question 7: Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?**

Yes. We suggest cross reference to the BEIS Guidance on the new reporting requirement for large private companies, specifically the reference to the Wates Principles and a requirement for a supporting statement for each principle explaining how it has been applied to achieve better outcomes. The Listing Rule for public companies refers to reporting 'in a manner that would enable shareholders to evaluate how the Principles [CGC] have been applied.' Similar wording could be used in the context of how companies must report on the Wates Principles, subject to the reference to shareholders being replaced by stakeholders.

It must be made clear that all companies which say they adopt the Wates Principles must provide supporting statements.

**Question 8: The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?**

We hope that the Kingman review will consider monitoring in respect of public and large private companies. The problems which have arisen from the piecemeal development of standards for different types of companies must not be repeated by a piecemeal approach to monitoring compliance by different types of companies. Any indirect interest shown by credit reference agencies is too uncertain to be satisfactory.

**Question 9: Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?**

No, and one reason for this is that guidance for consideration which is non-binding and non-exhaustive is a significant downgrade from 'comply or explain' provisions. The tiering described in Q1 would allow a different status for different private companies, ie, 'comply or explain' provisions may be appropriate for large private companies, but non-binding guidance may be appropriate for other private companies.

**Question 10: We welcome any commentary on relevant issues not raised in the questions above.**

It should be made clear the Wates Principles are applicable to subsidiaries. This is consistent with requirement for large private companies (including subsidiaries) to make statements of their corporate governance arrangements.

The guidance to Wates Principle One refers to internal audit, ethics, compliance and risk management as expected functions. The guidance to Wates Principle Three refers to establishing

committees in these areas, and in other areas such as nominations, remuneration and sustainability, as optional. In order to avoid confusion we suggest that these points are brought together, and an explanation added which says that: these functions can operate without committees; but there are advantages to collective decision-making; ultimate responsibility still rests with the board; and committees need Terms of Reference.

The guidance to Wates Principle One refers to key stakeholders and Principle Six refers to material stakeholders but neither description is defined.