THE 100 GROUP
Investor Relations & Markets ccommittee

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Financial Reporting Council
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Dear Catherine

Proposed revisions to the UK Corporate Governance Code

We welcome the opportunity to respond to the Financial Reporting Council's (FRC's) consultation on revisions to the Corporate Governance Code. We have shaped our response with an objective of supporting and ensuring that the highest standards of corporate governance are maintained, together with the UK's position as best in class

We agree with the comments Sir Win Bischoff made at the launch of the consultation. These echoed our response to the Government's Green Paper on Corporate Governance Reform: that effective corporate governance underpins long-term company performance. The inherent flexibility of the UK "comply or explain" model allows for more demanding standards than those capable of being achieved through onerous legislative requirements. This has led to the UK having some of the highest standards of corporate governance in the world, which in turn makes the UK an attractive market for new investment. We welcome the FRC's support in ensuring that the UK remains attractive for investment as such, any changes to UK Corporate Governance must ensure that UK as a whole, and its businesses remain competitive in the global capital markets. However, we have an overarching concern that the proposed revisions appear to be moving away from the concept of "comply or explain" principles to a more prescriptive approach.

Whilst we have not responded to all of the individual questions raised in the consultation document, as certain questions are best left to individual companies or other stakeholder groups, we have included in the appendix to this letter detailed responses to a number of the questions.

The introduction to the consultation makes reference to the Government Green Paper on Corporate Governance Reform and outlines a number of UK specific issues that the revised Code is seeking to address. We are concerned that the proposals, whilst generally supportable, may not necessarily provide an effective solution for achieving the underlying aims. The proposals are aimed at addressing the perception of corporate governance in the UK but, for many of our members, UK stakeholders are only one of many global stakeholder groups. There is a risk that the view of the UK stakeholder may not, when considered across the organisation as whole, be reflective of that stakeholder group and therefore the effectiveness of the revisions could be limited or difficult to implement successfully.

We note that the consultation makes reference to secondary legislation in respect of executive pay ratio reporting and company reporting of the consideration of section 172 requirements. We strongly recommend that the FRC allows sufficient time for companies to comment on any such legislation and any further amendments to the Code before issuing the revised Code. This is, in our view, preferable even if it results in a secondary revision to the Code.

We have significant concerns with the proposals in relation to the Independence requirements. We note that the consultation did not seek specific comments in relation to the amendments to provision 15, which prescribes the criteria when a director cannot be considered independent (rather than factors to be considered by Boards, who are in possession of relevant context and facts, as currently required). Nor did it seek specific comments in relation to the changes outlined in provision 11 whereby more than 50% of the Board, including the chairman, should be Independent. We have included our comments in relation to these two changes within our response to questions 7 and 8, and we urge the FRC to ensure that it has sought appropriate feedback in relation to both these proposed amendments. We believe that there is a risk that either responders overlook these amendments and/or the FRC take silence as confirmation of support.

Our concern is that a combination of the increasing time requirements on Independent Board members (as acknowledged by the FRC in relation to the remuneration proposals included within this consultation); the proposed amendments as to who can and cannot be considered to be independent and changes to Board composition; coupled with the need to ensure a diverse and inclusive Board and the relatively short implementation period may result in a number of companies not being able to be compliant with the revised Code. In our view, making these changes will create practical difficulties for Board composition, and risk creating less effective governance at least in the short term. We are also concerned that the "comply or explain" model is being limited by these changes. Our strong preference is that the "comply or explain" option is maintained with a greater focus on ensuring that explanations are specific and comprehensive.

Who we are

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the UK FTSE 100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers

Please feel free to contact me at juliawilson100group@kpmg.co.uk should you wish to discuss our comments. I would be more than happy to meet to discuss these, or any other relevant items, further.

Yours sincerely,

Julia Wilson
Chair
Investor Relations and Markets Committee

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

The UK “comply or explain” model provides flexibility both to companies and standard setters to adapt quickly to changing business and investor needs, as well as responding to broader social narratives. In theory, this allows all companies to apply the revised Code from 1 January 2019. We are concerned that the relatively short implementation period will, more likely than not, increase the number of companies explaining areas of, and reasons behind, non-compliance with the revised Code which, particularly in light of recent events, would be detrimental to the underlying aims of the revised Code.

For example, the revised Code seeks to both strengthen the Independence assessment of non-Executive Directors and intensify Board’s focus on diversity. A six-month implementation period does not provide Boards with sufficient time to assess Board composition needs or source high quality candidates. Additionally, in certain sectors there may be a shortage of suitable candidates available.

Given that the Code is, currently, only mandated to be applied by FTSE listed companies, we are concerned that a 1 January 2019 application date may, in the short-term, worsen “public trust in business” which is at odds with the aims of the proposed revisions as outlined by the FRC.

As a minimum, we propose that a transitional arrangement is put in place such that Boards are only required to be compliant with the revised Code via the "comply or explain" model" as at the reporting date rather than throughout the period. This arrangement would be in place only for the year that the revised Code is first effective

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

The proposed revisions to the Code outline the Board’s responsibility for considering the needs and views of a wider range of stakeholders. We understand that the Government has specifically requested that the FRC consult on a specific Code Principle relating to companies taking into account wider stakeholder views and on a Code Provision requiring the adoption, on a “comply or explain” basis, of one of three employee engagement mechanisms.

We were pleased to see that the proposed reforms do not mandate Board positions to specific stakeholder groups. Whilst we recognise the intention of the Government’s original proposal, we believe the principle of a unitary Board is fundamental to effective Board performance and therefore to effective corporate governance.

The three options outlined in the consultation reflect some of the alternative solutions that we outlined to BEIS. As such, we consider them to be practical (but not exhaustive) examples of the types of solutions companies may employ to meet the requirements of the revised Provision 3. We believe that it is best left to individual companies to assess which mechanism would best allow them to meet the requirements of Provision 3, and would encourage the FRC to include flexibility for companies to adopt one of the three options or any other equivalent mechanism which their Boards consider appropriate for their organisations.

It remains unclear, both from Government and this consultation, how wide ranging the stakeholder voice is meant to be. The Government’s initial Green Paper was aimed at addressing corporate governance in the UK, and, as outlined in paragraph 5, the feedback from this has shaped this consultation. For our membership, UK stakeholders are one of many global stakeholder groups. For example, our members employ approximately 7% of the UK workforce, which means that the majority of the UK workforce is employed by other large businesses, SMEs and the public sector. Additionally, for some of our members, the greater part of their workforce is comprised of non-UK employees. As such, specific Board focus on UK employees may not represent the wider stakeholder group voice, when considered across the organisation as a whole, nor represent the concerns of the majority of the UK workforce, which could therefore limit the effectiveness of what the proposed revisions are trying to achieve.

We understand that the government will issue secondary legislation shortly, in relation to company requirements over section 172. Therefore, we suggest that the FRC delays issuing the revisions to the Code until this legislation is finalised, to ensure that the revised Code is consistent with UK Company Law.

We would welcome the opportunity to discuss this, and possible solutions, further with you.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

Given that it is currently unclear how the Department for Culture, Media and Sport and HM Treasury will take the recently published report '*Growing a Culture of Social Impact Investing in the UK*' forward, we would recommend no specific reference is made to the UN SDGs or other NGO principles in the Code.

The SDGs are one example of a useful context in which companies can engage with wider stakeholders and report on their contribution to / impact on wider society, and we understand that there is an increase in focus from UK investor groups in this area. However, for some of our members – particularly those with high-levels of overseas shareholders – these are not necessarily topics that their investors assign significant value to. As such, we recommend that any specific mention of them is included only within the guidance as an example of one of the ways that the Board can engage with investors.

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

In our experience, our members have existing internal policies to consult with shareholders when there are significant votes cast against a resolution; as such we believe, in general, that companies are already ensuring that they "fully understand the reasons for shareholders voting against a resolution and that [they] can enter into dialogue with shareholders to discuss these matters further".

We do not understand the logic for the 20% threshold, particularly if it is to be linked to a prescribed response. 25% has the merit of being equivalent to a special resolution failure for example. Further, we believe that the requirement to publish an update no later than six months after the vote is impractically short and not in tune with most companies' investor engagement cycle.

Furthermore, engagement with Proxy Advisors can be challenging and we would encourage the FRC to consider their role more fully in this context.

We believe that a better approach would be to require companies to outline their policies for consultation when significant votes against, (preferably as defined by the company), are received and summarise such consultations in the annual report.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

We concur with the FRCs proposals outlined in paragraph 48 that "the Code sets good practice and that even smaller companies should strive for the highest standards of corporate governance".

As outlined in our response to the Government Green Paper, we would welcome an extension of the Corporate Governance framework to the UK's largest businesses, which are currently outside of the scope of the Code, including both AIM Listed companies and privately owned companies. We believe this will go a long way in achieving the aims of the revised Code, as some of the most high profile failures have been in large private companies, and it is often assumed such companies are required to comply with the same governance standards as premium listed businesses due to their size.

However, we would recommend that subsidiaries of listed companies applying the Code, are either omitted from the proposed extension or exempt from the reporting requirements, as in order to comply with the Code at a UK PLC level our members implement governance structures with which all subsidiaries, regardless of domicile, are required to comply. As such, capturing such companies would result only in increasing the reporting burden, without any substantive improvements to corporate governance in the UK. We recognise that acknowledgement of such exemption would be beneficial and would recommend that any large privately-held company taking this exemption should include a disclosure to that effect in their annual report.

Q7 & Q8 Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent? Do you agree that it is not necessary to provide for a maximum period of tenure?

The consultation does not seek feedback on the proposed change of approach to the consideration of Independence by Boards. We consider this to be a fundamental change, and strongly recommend that the FRC consults with a range of stakeholders on this amendment. As there is no specific question seeking feedback on the proposed amendment there is a risk that either responders overlook the lack of consultation in relation to this amendment and/or the FRC take silence as confirmation of support.

Specifically, we recommend that the FRC revisits whether the following two provisions would automatically mean that a Non-Executive Director should, by default, be considered as non-Independent. In our opinion, ensuring that Independent Non-Executive Directors have appropriate business knowledge is key to an effective Board.

- "has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; or
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;"

A company's Board, in possession of the relevant facts and context is best placed to determine whether an individual is independent, notwithstanding the existence of one or more of these factors.

Additionally, we note that the FRC has also not sought to consult on the revised provision 11, which states that Independent Non-Executive Directors and the Chair should constitute the *majority* of the Board. The current Code asserts that 'at least half the Board, excluding the chairman, should compromise non-executive directors determined by the Board to be independent'.

The proposed changes to the definition of 'Independent' and the composition of the Board may result in Boards having to significantly alter their composition before the revised Code is effective. As noted in our response to question one, we are concerned that there may be insufficient time and a lack of suitably high-calibre candidates available for companies to make the necessary changes before the revised Code is effective.

Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

In our experience, the Boards which our members represent are aware of the benefits that a diverse Board, executive pipeline, and wider workforce, can bring to a Company, and have been focused on all aspects of diversity for a number of years. We welcome the FRC's commitment to ensuring that all companies within the scope of the Code are proactive in considering diversity and inclusion.

We note that provision 17 brings the consideration of diversity and inclusion within the scope of the Nomination Committee and provision 23 outlines that a description of the work the Nomination Committee has undertaken in this area should be included within the Annual Report. We understand the FRC's rationale for including this and support the overall objective.

In some sectors, there is already a shortage of well qualified diverse candidates. We are concerned that the proposed changes to the determination of Independence may unwittingly further exacerbate this, by excluding otherwise well qualified diverse candidates.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

As noted in our response to question 6 – it is often assumed all large companies are required to comply with the same governance standards – as such, we would welcome a common set of criteria applicable to all premium listed companies, irrespective of size.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

It is unclear to what level the FRC considers the 'executive pipeline' outlined in provision 17 to extend, and this is not defined within the revised Code or guidance. Provision J makes reference to 'Senior Management', which is defined in footnote 3 to be "the executive committee or the first layer of management below board level, including the company secretary". From our stakeholder engagement we understand that there is already divergence in interpretation of 'executive pipeline' with some groups considering this to be succession planning for Executive directors, and others considering this to extend to Senior Management, as defined in Provision J.

Whilst we do not object to the reporting of ethnicity in executive pipelines, we would suggest that the implementation of any such reporting requirement follows previous processes e.g. gender pay reporting. This would allow companies to comment on proposals and reporting requirements, whilst also providing appropriate time to make any necessary amendments to internal reporting processes.

In our view, a step change to reporting in this area would not be beneficial in achieving the underlying objective because, as noted above, there is already divergence in interpretation which, without clarification, will inevitably lead to divergence in reporting. Additionally, the lack of common internal reporting structure of companies – even within the same sector – would mean that a common definition would be required before any such reporting is meaningful to users.

Q14 – 16 . 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? Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance? Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

We do not have any specific concerns with expanding the wider remit of the remuneration committee, other than the potential impact on the Independence assessment (as outlined in the body of our letter). In our opinion, the most effective way of discharging the increased responsibility will be via the delegation of oversight for certain workforce policies to other committees, where these exist, as they might be better placed to deal with such matters.

The significant changes in landscape and requirements in relation to executive remuneration (e.g. the move from defined benefit to contributory pension schemes; the requirement for an element of bonus to be linked to future performance), coupled with the complex reporting requirements, have not always achieved their original objectives, and transparency is being lost in the complexity of required disclosure. We acknowledge that public concerns about excessive executive pay is a key contributor to the fall in trust in business, and want to work with government and regulators to find an effective solution whilst ensuring retention of talent (both current and for succession planning).

The current reporting requirements are already overly complex and form an extensive part of the annual report. As such, the Remuneration Committee Chair's letter is often used to outline the policies and pay for the Board and senior management in plain English. Adding more disclosure would not, in our opinion, achieve the aim of the proposals, nor would it aid understanding of remuneration structures. We recommend that a review of the reporting requirements, alongside the FRC's "cutting the clutter" initiative, is undertaken. We believe this would lead to a simplified report which would enhance users' understanding of the remuneration policies applied, facilitating, where necessary, more effective challenge and greater accountability.

As global organisations, we seek to attract and retain the best global talent, which is not necessarily based in the UK. Consequently, remuneration packages may be denominated in currencies other than sterling, and any depreciation in sterling would, therefore, result in a reported increase in remuneration for such executives, which may distort or misrepresent the underlying movements in such remuneration packages when included in prescriptive metrics. In order to ensure meaningful disclosure, extensive narrative explanation would be required, adding to the complexity of remuneration reporting and the potential for unhelpful misinterpretations.

As the members of the 100 Group are the subjects of remuneration policy, we recognise the potential for conflict and so have not sought to comment on the specific proposals in relation to Executive pay and pension included in the revised Code.

We believe that Boards do have sufficient impetus to exercise discretion in relation to executive pay; as do shareholders who can hold companies to account on executive pay and performance via the triennial binding vote on the company's remuneration policy.