Trust through governance

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Dear Catherine

Proposed Revisions to the UK Corporate Governance Code

We welcome the opportunity to comment on the FRC's consultation on proposed revisions to the UK Corporate Governance Code.

As you know, the Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries. Company secretaries have a key role in advising companies on their governance arrangements and for governance reporting, and our members are therefore well placed to understand the issues around the proposed revisions to the UK Corporate Governance Code.

We have set out below our responses to the questions set out in your consultation. However, we are aware of the EU Commission's Recommendation on 'comply or explain' recommendations and wondered whether amendments to the Code to reflect this Recommendation might also be considered at this time.

1. Directors' remuneration

Q1 Do you agree with the proposed changes in Section D of the Code?

Yes. The proposed limited changes to section D of the Code are broadly acceptable. We agree that more extensive changes to the Code should not be considered until the impact of recent legislative changes to remuneration reporting has been assessed.

The proposed changes will provide for additional flexibility in Remuneration Committee discussions and remuneration arrangements. The changes should also improve the link with long-term strategy and lead to more variable and meaningful reporting by companies.

Q2 Do you agree with the proposed changes relating to clawback arrangements?

No. We have concerns over the focus on 'sums paid' in the proposed change to D.1.1. It is our view that this narrow focus on clawback is too restrictive and it is important that companies also look at other ways to withhold or retrieve variable pay, where appropriate. There needs to be consideration of malus along with both deferred vesting and split vesting of awards, which we consider to be more effective ways to achieve the same outcome. It is our view that clawback is unlikely to work in practice and we think, therefore, that any changes to Code Provision D.1.1 and Schedule A should include a wider definition to encompass other, more effective, ways of withholding or retrieving variable pay.

Q3 Do you agree with the proposed change relating to AGM results? Is the intention of the proposed wording sufficiently clear?

No. We have concerns over the lack of any clear definition of 'significant' and the proposal that this be 'in the opinion of the board'. We are not suggesting the Code should be more prescriptive in this area; but we think that the proposed change will ultimately lead to uninformative 'boilerplate' reporting. In our view, the proposed change is sufficiently vague that it would be preferable if it were left to individual companies to decide, according to their circumstances, whether an announcement would be appropriate, without including any provision in the Code.

Q4 Do you agree with the proposed amendments to the Schedule?

Yes, in part. We agree with the proposals for increased disclosure on individual elements of remuneration and on incentives. Many companies already report this information.

However, we have concerns over the proposal that directors be required to hold shares for a period after leaving the company as we do not think this would be feasible. It may be possible to provide that a vesting period extends to a time after a director has left the company; however any requirement that a director be prevented from selling shares they own after they have left the company would be unenforceable. It may be possible to enforce certain restrictions on a director selling shares prior to leaving a company, but an unfortunate consequence of such action would be to prejudice long-serving directors who would thereby be prevented from selling their shares simply because they had remained with the company.

2. Risk management and going concern

Q5 do you agree with the changes to the Code relating to principal risks and monitoring the risk management system?

Yes, in part. We support the change of wording from significant risks to principal risks in Main Principle C.2. This change aligns the wording with the required contents of the strategic report and with EU legislation, and represents a more realistic approach.

However, we note that the proposed new wording at C.2.1 will require a *robust* assessment of the principal risks and a description how they are managed *and mitigated* and we have concerns over the words we have highlighted in italics. It is impossible to identify all possible risks that could threaten the business model, future performance, solvency or liquidity, and it is therefore difficult to know how directors would be able to state this without such extensive caveats as to make any disclosure meaningless. We note that the consultation has considered the difficulties with disclosure of the mitigation of risk for US listed companies, and would observe that, under the current wording, 'mitigation' of risk is most likely to be interpreted in the US as the risk itself having been 'managed away' (ie having been neutralised).

Q6 Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?

No. We understand the wish to clarify the nature of the 'going concern' statement under the listing rules in order that investors do not misunderstand the nature of this statement. We therefore support the proposed wording in C.1.3 to make clear that it should not be read as the company making a 'viability statement' and should not be taken to be any wider than the company's ability to continue trading for at least twelve months.

We also think that it is understandable that investors would like to be reassured that boards are having appropriate discussions on the principal risks faced by the company and the sustainability of the business. However, for the reasons given in our response to question 7 below, we believe that the proposed requirements for a 'viability statement' will lead to meaningless lengthy statements in annual reports that will largely comprise 'boilerplate' wording, with so many caveats they will fail to achieve the intended result.

We think it would be preferable for the FRC to mandate that an assessment be carried out by the board and that companies report on their processes, rather than require statements on the outcome on any 'viability assessment', which we think will be meaningless and of little value.

Q7 Do you agree with the way proposed Provision C.2.2 addresses the issues of the basis of the assessment, the time period it covers and the degree of certainty attached?

No. We think the wording of new Code Provision C.2.2 is vague and presents a number of problems. We do not think it is realistic to expect directors to report on their company's prospects for any period longer than 12 to 18 months into the future. Directors can only report on information they have and cannot reasonably be expected to foresee possible future events with sufficient confidence to make the statement envisaged by C.2.2. Reporting on the company's prospects further into the future would be subject to so many possible events over which the company would have no control that we think this will lead to meaningless disclosure.

To provide an example of how unforeseeable future events may affect a company's prospects, we would highlight the recent government announcement on changes to pension rules. This event is a political risk that was completely unforeseeable by the life assurance industry and will have a serious impact on the future prospects and current business model of companies that provide pension annuities. Other companies could also be subject to unpredictable future events from time to time and sectors such as mining or pharmaceuticals, where the natural business cycle extends over many years, cannot possibly know what risks they may encounter over such a long period of time. Likewise, companies that operate internationally will always encounter foreign exchange risk as well as political and regulatory risks, all of which tend to be both unpredictable and volatile.

We would, therefore, advocate a provision that requires boards to report on the process carried out to assess the principal risks and the prospects of the company, as mentioned in our response to question 6 above, rather than a requirement that the company make a statement on the findings of the assessment as envisaged by Code Provision C.2.2.

We also have a concern over the wording in Code Provision C.2.3. It states that *"the board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls."* Appendix B makes it clear that the report by the board under Code Provision C.2.3 *'should explain what actions have been or are being taken to remedy any significant failings or weaknesses identified from that review'*. It is difficult to imagine circumstances where a board would report on action taken to remedy significant failings or weaknesses, without reporting the details of the actual failings identified. We would suggest that reporting under C.2.3 should be proportionate and reporting limited to failings that are 'material' or 'significant'.

Q8 Do you have any comments on the draft guidance in Appendix B on the going concern basis of accounting and/or the viability statement?

Yes. As highlighted in our response to question 7 above, Appendix B will require boards to report on their review of both going concern and viability *and* discuss any significant findings. We have concerns that this would lead to a need for additional discussion of specific issues identified, as well as how the company has addressed and remedied the issues, without any safeguard to ensure companies do not have to disclose information that is commercially sensitive.

Q9 Should the FRC provide further guidance on the location of the viability statement?

Yes. If a longer term viability statement is to be required in the annual report we think it would be appropriate to include this statement with the principal risks and uncertainties. We also think it would be helpful for companies to include their going concern statement with the principal risks and uncertainties, rather than in the notes to the accounts.

Q10 Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?

No. We do not think a requirement that companies should report on action taken to address significant failings or weaknesses is helpful. We think it should be left to the board to report on any action taken as it considers appropriate in the circumstances.

If it is decided that this recommendation be retained, we think there will be implications for the auditors and therefore guidance for both auditors and companies would be helpful.

3. Location of corporate governance disclosures

Q11 Option for Corporate Governance statements to be put on companies' websites and are there any elements to always be included in the annual report?

We understand the assumed benefits of having corporate governance statements on companies' websites are to provide for shorter annual reports and potentially easier access to such information. However, we think that, for a number of reasons, the perceived benefits are not borne out in practice.

- We think that this proposal could undermine proper discussion and disclosure of compliance with the Code and lead to an increase in 'boilerplate' corporate governance statements, or an attempt to 'bury' difficult information on website.

- The proposal would appear to be at odds with the current focus of FRC and the EU Recommendation to improve the quality of Code explanations.

- The information contained in the annual report is at a single point in time whereas there is an expectation that information contained on a company's website will be updated frequently.

- It is not clear how this proposal would be helpful to any shareholders or other stakeholders. It would also be difficult to determine what information should be moved to websites and which elements, if any, should be retained in the annual report. It is our members' experience that different interest groups tend to want different information to be included in the annual report.

- Our members' experience is also that the majority of shareholders and other stakeholders prefer corporate governance statements to be contained within the annual report as they find it is easier to locate the information and review it in the context of the relevant company's financial performance. This is the case whether the information is sought from a printed copy of the annual report or accessed via the company's website.

On balance we think, therefore, that the Code should continue to require that corporate governance statements be included in the annual report. However, the option for companies to put corporate governance statements separately on their websites, in addition to including the statements in the annual report, should remain.

Q12 Are there any disclosure requirements in the Code that could be dropped entirely?

No. We think that all the disclosure requirements in the Code are important and to remove any disclosure requirements would undermine transparency relating to governance.

We hope you find our comments helpful and would be happy to expand on any of these points should you wish to discuss them further.

Yours sincerely

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