The City of London Law Society

The Law Society

Response to the FRC's Consultation Document on the UK Corporate Governance Code (May 2023)

13 September 2023

Introduction

1. The views set out in this response have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society ("**CLLS**") and the Law Society of England and Wales (the "**Law Society**"). The response also contains the views of the CLLS ESG Committee and the Law Society Climate Change Working Group.

2. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to company law and corporate governance.

Response

Part A – Over-arching comments

5. The UK Corporate Governance Code (the "**Code**") has been an important driver of positive developments in corporate governance policies and practices over the years. Its success in this regard has been rooted in the 'comply or explain' nature of the Code and the inherent flexibility which has allowed companies which have adopted the Code, whether as a requirement of the FCA's Listing Rules or voluntarily, to tailor their approach and their disclosures to what they think best fits their particular circumstances and business model. It is important that any changes to the Code continue to allow for this approach if they are to achieve the goal of enhanced transparency with a focus on reporting on outcomes. As is noted in the foreword to the FRC's consultation document on the Code issued in May 2023 (the "**Consultation Document**"), boilerplate statements – simply playing back the words within the Code – will not achieve this goal. Equally it will be important that investors and proxy advisers consider explanations for departures from the Code thoughtfully and acknowledge that while a departure from the Code may constitute 'non-compliance', it is not *per se* indicative of a failure to have effective governance. The FRC should consider whether further changes to the Stewardship Code are needed to reinforce this important point.

6. Key points arising from our review of the proposed changes to the Code are:

   - **Avoid duplication** – a number of proposed changes to the Code involve adding provisions or requirements that are addressed in other legislation (for example, the Companies Act 2006 and related financial and non-financial reporting regulations) or other regulations (for example, the Listing Rules or Disclosure Guidance and Transparency Rules). This is particularly the case in relation to topics such as reporting on diversity, remuneration and climate-related matters, as well as the Government's proposals for a resilience statement and an audit and assurance policy. We believe it is important that the Code does not simply impose additional requirements on top of those which already exist or will exist by the time the revised Code takes effect. At the very least, companies which are subject to an equivalent obligation under English company law or the FCA's Listing Rules should be able to refer to such obligation (and any disclosure / explanation in relation to it) and this should constitute compliance with the equivalent requirement in the Code without the need for

further duplicative disclosure or explanation. In speaking to our clients, many of them have concerns about the overall effect of the aggregate non-financial reporting requirements under the various applicable rules and the proportionality of this for many of the affected companies. The FRC should have regard to these wider concerns when considering changes to the Code and seek to avoid exacerbating them.

- **Retain 'comply or explain'** – as noted above, 'comply or explain' is a key cornerstone of the Code's effectiveness. Whilst we generally support the focus on improving the quality and transparency of explanations of any departures from the Code, it is important that the ability of companies to 'comply or explain' is not reduced or undermined. This is particularly important in the context of avoiding any adverse impact on the ability of the UK to attract and retain international businesses. We are particularly concerned that a number of the proposed changes to the Code would introduce new requirements as Principles, rather than Provisions. As the FRC will be very well aware, the Listing Rules require companies to make a statement of how they have applied the Principles, which is in contrast to their ability to 'comply or explain' in relation to the Provisions. 'Comply or explain' importantly allows companies to adopt an alternative approach which still ensures effective governance consistent with the application of the Principles. Increasing the requirements reflected in the Principles reduces this critical flexibility.

- **Proportionality** – it is important that the proposed changes to the Code are proportionate in what they require of companies both as regards the nature of the requirements and the potential costs of complying with them. This is particularly the case given the Code applies to a very wide spectrum of companies ranging from large cap companies operating across many international markets to non-UK companies which have chosen to list in London to small cap companies with more limited resources. In this regard, we note that the FRC does not appear to be proposing to undertake an impact assessment in relation to the proposed changes to Section 4 of the Code. This is notwithstanding that the proposed additional reporting and assurance requirements could result in a significant increase in costs for companies and additional responsibilities for the board and the audit and/or risk committee. This may impact adversely on the willingness of individuals to become members of boards and/or those committees at a time when attracting a high quality and diverse pool of non-executive director candidates can already be challenging.

- **Increased specificity** – related to the concepts of 'comply or explain' and proportionality, a number of the proposed new reporting requirements are increasingly specific and detailed in what they require from companies. In particular, these include environmental and social matters, time commitments for directors, risk mitigation and strategy. In focusing on certain current governance concerns, these additional specific requirements may result in boilerplate disclosure (to avoid any potential adverse reaction in explaining non-compliance). Further, there is a risk that boards might consider such requirements to be mandatory, thereby limiting any objective assessment of the risks facing the business and reducing the flexibility for the board to set the company's strategy in a manner they consider best fits the business.

- **Guidance** – in many areas, it may be that the proposed changes can be best achieved through enhanced guidance, as noted in paragraph 10 of the Consultation Document. The guidance previously published by the FRC would appear to have been very helpful in encouraging more effective governance and more meaningful disclosure. It will be important however that any further guidance, and in particular any examples and case studies, continues to reflect the fact that there is no 'one size fits all' solution and that a range of approaches can be equally effective depending on the particular circumstance of the company in question. Equally, the FRC should seek, where possible, to consolidate rather than proliferate the guidance that is available so as to avoid there being an overwhelming volume of guidance for companies to take account of in considering the application of the Code.

- **International companies** – we note that the Code seems to be increasingly focused on large UK companies. For example, Provision 5 refers to section 172 statements, and the new draft Code refers to the new audit and assurance policy and resilience statement requirements (which will apply to so called '750:750 companies'), as well as the new Minimum Standard for Audit Committees which is aimed at premium listed FTSE 350 companies. A particular concern with this approach is that if the Code ends up being applied to all companies admitted to the new Equity Shares in Commercial Companies category, including those which currently only have a standard listing of equity shares (as proposed by the FCA's consultation paper CP23/10), there is a risk of a gap in understanding or lack of clarity as to the expectations for overseas/non-UK companies in particular, whom relevant stakeholders are trying to attract to the new listing category. We think it would be helpful therefore if there was more flexibility and guidance, either in the Code or in the Listing Rules (or both), around how these provisions are intended to be addressed by (i) smaller companies outside of the FTSE 350 and (ii) any overseas/non-UK companies which are listed in the UK but are not otherwise subject to the UK regulatory and company law framework.

7. The CLLS and the Law Society welcome the opportunity to respond to the Consultation Document and are keen to continue to work closely with the FRC in relation to the development of the Code. We would be pleased to meet with the FRC to discuss in more detail the points raised in this response.

Part B – Responses to the questions in the Consultation Document

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

8. We note that the FRC has been encouraging more outcomes-based reporting across a number of areas including corporate reporting and stewardship reporting.

9. In particular, we note that reporting on the application of the Code's Principles was an area of focus in the FRC's Annual Review of Corporate Governance Reporting published in November 2022 (the "**2022 Annual Review**"), with the key message being that "*High-quality reporting should show in a clear manner how the board has successfully applied the Principles of the Code to achieve effective outcomes for the company, shareholders and other stakeholders*". We also note that the existing Introduction to the Code already encourages companies to do this:

   "It is important to report meaningfully when discussing the application of the Principles and to avoid boilerplate reporting. The focus should be on how these have been applied, articulating what action has been taken and the resulting outcomes. High-quality reporting will include signposting and cross-referencing to those parts of the annual report that describe how the Principles have been applied. This will help investors with their evaluation of company practices."

10. We can see that including a specific reference in Principle D to the requirement for reporting to focus on outcomes will increase awareness of this issue and will hopefully improve reporting on how the Principles of the Code have been applied and deliver more outcomes-based reporting (both in this regard but also in reporting more widely, for example in relation to the outcomes of stakeholder engagement as also highlighted in the 2022 Annual Review). However, in our view, simply adding a requirement to the Code in relation to this will not necessarily change behaviours. Listing Rule 9.8.6R(6) already requires listed companies to address the 'comply or explain' nature of the Code and to provide the reasons for any non-compliance. The provision of specific guidance on this issue is likely to be necessary – one option could be an in-depth FRC Lab Project with the resulting guidance then being linked to the reference in Principle D by way of a hyperlink.

11. Further, the proposed new Principle D extends the requirement for outcomes-based reporting to "*how the Code has been applied*" (not just the Principles as currently). This would appear to require an outcomes-based explanation even where a company fully complies with a Provision, i.e. a

'comply <u>and</u> explain' approach. Is this intended? If so, then it would be a very significant change and conflicts with the 'comply or explain' requirements in LR 9.8.6R(6), LR 9.8.7R and DTR 7.2.3R(1). We would question why stakeholders need such additional disclosure. If this is not intended, then we recommend amending the first sentence of Principle D to end: "…*the impact of governance practices, how the Principles have been applied and any non-compliance with the Provisions*".

12. There is also a risk that companies will only want to report on positive outcomes. Before a requirement for outcomes-based reporting is added to the Principles, it might be helpful for the FRC to further explore why companies are not currently meeting its expectations regarding outcomes-based reporting despite the FRC's drive to encourage it. Is this simply because companies are not sufficiently focused on reporting on the effect that a particular governance policy or activity has had when considered against its intended outcome? An outcome is often seen as a response to an action – a company with a well-established, efficiently operating governance environment which applies all aspects of the Code may (in seeking to provide outcomes-based reporting) resort to reporting in fairly generic terms which does not lead to meaningful reporting. As noted above, guidance and examples may help to enhance reporting in this regard.

13. For meaningful 'outcomes-based' reporting, we would welcome guidance detailing what is meant by this (does this just mean 'clear and understandable' explanations of whether a particular aspect of governance has achieved its intended aim?) and how to comply with the new requirement. For example, are companies expected to report on the outcomes from engagement with stakeholders and/or the outcomes resulting from particular governance policies they have put in place? Examples of what might constitute a clear outcomes-based explanation of non-compliance are likely to help mitigate the risk that companies will only report on positive outcomes (or that the new requirements result in more boilerplate language).

14. We would also like clarification as to whether the new requirement to report on "*departures from the Code's provisions*" is applicable only to Section 1, or whether it is intended to apply to the whole Code. If it is the latter, then we suggest that it should be moved to the Introduction to the Code (to the extent that it is not already covered) so as to avoid it being read as applying only to Section 1.

15. See also the response to Question 2 regarding guidance on the Strategic Report.

Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

16. There are a number of pieces of existing legislation, regulation and best practice guidance which govern disclosure requirements in relation to environmental, social and governance ("**ESG**") matters, often with conflicting aims and, as a result, introducing a lack of certainty around disclosure requirements in relation to environmental and social matters (as noted in the FRC's report '*Audit Committee Chairs' views on, and approach to, Environmental, Social and Corporate Governance (ESG)*' published in June 2023 (the "**ACC Report**")).

17. For example, just in relation to the climate ambitions and transition planning of premium listed UK companies, these include:

- the requirements for TCFD reporting under the FCA's Listing Rules for financial years beginning on or after 1 January 2021;
- the requirements for a variant of TCFD reporting introduced by the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 for financial years commencing on or after 6 April 2022;
- the streamlined energy and carbon reporting (SECR) requirements introduced by the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 which replaced the prior regime for financial years beginning on or after 1 April 2019;

- the ongoing work of the Transition Plan Taskforce (launched by HM Treasury) on transition plans. The Government intends to require the UK's largest companies to disclose their transition plans if they have them;
- the FRC's July 2023 call for evidence to inform the proposed endorsement of the new IFRS Sustainability Disclosure Standards (IFRS S1 and S2) in the UK; and
- the FCA's process for implementation of IFRS S1 and S2 (as noted in Primary Market Bulletin 45).

18. In our view, including references (in broad terms) to environmental and social matters in Provision 1 of the Code is duplicative and overlaps with a number of existing disclosure requirements. This could result in either repetition or contradictory disclosures, leading to a lack of clarity around key information. This is a particular risk in the rapidly developing area of climate reporting and transition planning. We consider it would be better to allow additional reporting in this area to be governed by tailored rules designed for this purpose (like those mentioned above).

19. The impact of environmental and social matters on a company's business model and strategy will vary widely depending on the sectors and regions in which the company/group operates and the specifics of its business. There may be matters other than climate ambitions or transition planning on which a company should be focusing and which will have a greater potential impact on the delivery of its strategy. The board is best placed to identify those matters. Section 172 of the Companies Act 2006 (the "**CA 2006**") already requires directors to have regard to environmental and other broader social factors as part of a non-exhaustive list of considerations informing their decision-making process. While we understand that the Government is keen to ensure that ESG is part of a broader agenda to be considered by companies, we believe that any increased emphasis on this issue should be addressed through legislation if the intent is to change the balance of considerations for boards. We do not think that the Code should seek to constrain the board's flexibility in this regard or require it to give greater weight to environmental and social matters than the board considers appropriate, potentially in a manner which may be at odds with the directors' determination having regard to their duty pursuant to section 172 of the CA 2006.

20. We would also note that when, as is proposed, mandatory transition plan reporting is introduced, there will be an overlap between this and the proposed new reporting requirement which is being introduced at the end of Provision 1. We think any such duplication should be avoided in order to simplify the application of the Code and to allow companies to focus more on reporting on outcomes rather than on understanding the extent to which different requirements may or may not duplicate each other.

21. To reflect these points, we suggest amending Provision 1 to end: "… *and how environmental, social and other relevant matters are taken into account in the delivery of its strategy*" (then deleting the words which follow regarding climate ambitions and transition planning).

22. In that regard, the FRC's Guidance on the Strategic Report may be a better place to provide guidance on the type of environmental and social matters that a company may wish to report on as part of explaining how these are taken into account in the delivery of its strategy (which may include its climate ambitions and transition planning, but where the company has an ability to set its own priorities, purpose or plan).

23. As a related point, in relation to the FRC's intention to revise its Guidance on the Strategic Report, it would be helpful if the revised guidance could be consulted on in time for the final version to be available to companies sufficiently in advance of the changes to the Code and the new corporate reporting requirements coming into force so that they have time to prepare for the new requirements.

24. In particular, consideration should be given to updating the guidance on those aspects of section 414CB CA 2006 (the non-financial and sustainability information statement), which implement the EU's 2014 Non-Financial Reporting Directive ("**NFRD**"), and require companies to report on the

impact of their activities on the environment, employees, social matters, respect for human rights, anti-corruption and anti-bribery matters and community issues; as well as the policies pursued by the entity in relation to these matters and any due diligence processes implemented in pursuance of these policies together with the outcomes of those policies. These requirements overlap with the Code's requirements, and both are currently addressed in the FRC's Guidance on the Strategic Report. The NFRD introduced the 'double materiality' concept, i.e. the need to consider and report on the impact of the entity's activities and more outcomes-based reporting, but a review of how the NFRD has been implemented found that this concept was poorly understood and complied with. Steps have been taken to address this in the EU (but not the UK) through the introduction of the Corporate Sustainability Reporting Directive and the European Sustainability Reporting Standards. Accordingly, there is scope for more to be done on this in the UK.

25. We also have concerns that any additional requirements for companies to make forward-looking disclosures in relation to their climate ambitions and sustainability strategies and plans could expose the company and its directors to an increased risk of 'greenwashing' litigation. Any increase in the requirement for the disclosure of forward-looking information in this regard should be considered in the context of the Government's recent call for evidence in relation to non-financial reporting and the availability of 'safe harbour' protections for any such information. The goal of enhanced transparency and more focus on outcomes-based disclosure, as opposed to generic boilerplate disclosure, is only likely to be achieved if any increased requirements are considered holistically and having regard to the potential liability risk for those making the disclosures.

Q3: Do you have any comments on the other changes proposed to Section 1?

26. Principle A: We agree it is important that the board should ensure that the necessary resources and policies are in place.

27. However, we question whether Principle A should be extended to the board ensuring that the necessary "*practices*" are in place. The board's role is primarily to provide strategic leadership and high-level oversight, and under Provision 11 at least half the board (excluding the Chair) should be independent non-executives, not full-time employees. Accordingly, it is not appropriate to give the board a responsibility that arguably would require it to closely and continuously supervise the activities and practices of particular personnel.

28. Provision 2: additional guidance would be helpful for companies around what steps they can take to assess "*<u>how effectively</u> the desired culture has been embedded*" (emphasis added).

29. Provision 3: we suggest that the original drafting in the third line is reverted to – i.e. committee chairs should "*seek engagement*" rather than have an obligation "*to engage*" with shareholders on significant matters (there are two references to 'engagement' in Provision 3 which contradict each other, and this would address the inconsistency). Companies cannot force engagement to happen and we understand that many smaller companies often find that investors' priorities can prove a challenge in terms of achieving meaningful engagement.

30. Provision 4: we note that there are no proposed changes to Provision 4, however we would welcome clarity on the meaning of "*20% or more votes … cast against the board recommendation <u>for</u> a resolution*" (emphasis added) in the context of resolutions not proposed by the board. If, for example, the board recommends a vote against a resolution proposed by a shareholder, but the shareholder secures more than 20% support, the FRC Technical Q&A indicates that the company should go through the process set out in Provision 4 but this is not explicit in the Code. Is this what is intended in such situations? If so, then we suggest the reference to "*for a resolution*" is replaced with "*in relation to a resolution*" in order to help clarify the drafting of Provision 4.

Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

31. We broadly support the proposed changes to Principle K including the principle that directors' external commitments should be considered as part of board performance reviews. However, we note that in practice this is an area already covered as part of the external board evaluation process in most cases and is generally kept under review on an ongoing basis and assessed at the time that a new appointment is made. The new language in Principle K could be made clearer and/or guidance provided as to what the annual performance review is actually being asked to consider in relation to a director's commitments to other organisations – is the intention for an annual confirmation that each director has sufficient capacity to undertake their role effectively? If so, this is already addressed by Provision 15.

32. We also note that this Question 4 refers to Principle K making the issue of "*significant*" external commitments an explicit part of board performance reviews. However, Principle K itself only refers to "*commitments to other organisations*" which is arguably broader and would encompass any and all commitments regardless of their significance. We further note that Provision 15 refers to "*significant director appointments*". These references should, in our view, be made consistent and flexibility should be preserved if any guidance is to be issued relating to 'significant' in this regard as there can be considerable variance between the time commitment required by different external commitments depending on the applicable circumstances.

33. Please also see the response to Question 5.

Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

34. We recognise the need for companies to manage potential overboarding and the need for greater transparency, but it is hard to see what meaningful disclosure companies will be able to provide when "*describing how each director has sufficient time to undertake the role in light of commitments to other organisations*". We note that the commentary in paragraph 25 of the Consultation Document suggests that the number of board positions, committee roles and commitments is important. Whilst we recognise that the number of commitments can be a proxy for the time spent in relation to those commitments, this does very much depend on the applicable circumstances. The amount of time required to meet each director's commitments – to the company or other organisations – will vary over the year. While this disclosure requirement may be intended raise the issue of overboarding in the consciousness of directors, we feel that it will not necessarily change behaviour and may well only promote boilerplate explanations.

35. Greater disclosure of external commitments – especially ones which are not significant – is also likely to lead to proxy advisers issuing voting recommendations based on an overly simplistic assessment of the number of external commitments, rather than an assessment of the time commitment involved and the potential for them to detract from the ability of the director in question to discharge their responsibilities appropriately and to perform effectively as a director.

36. If Provision 15 remains as drafted, further clarity is needed as to what is meant by "*significant director appointments*" and we suggest that the Code or the Guidance on Board Effectiveness is revised to provide this. For example, should this include any board committee (or chair of a board committee) roles as part of other directorships? We also note, as outlined in the ACC Report, that the commitment required for any particular committee will differ significantly as between different types of companies, and therefore a simple list of director and/or committee roles may not provide meaningful disclosure. Additionally, are such "*director appointments*" limited to other roles as a director of a listed company, or would they capture appointments by other entities (such as building societies, private companies, trustees of charities etc.)?

37. Accordingly, we feel that it would be more helpful for directors to be expressly required to consider the time spent on other commitments, particularly in the context of the role of an independent non-executive director, as this relates to whether they have sufficient time to undertake their role effectively. However, any requirement to provide disclosure in respect of how each individual director is able to manage the demands on their time from their other commitments is likely to result in formulaic boilerplate disclosure which is unlikely to achieve the enhanced transparency that is being sought. For example, the company might just say that directors (like other company personnel) need to make frequent decisions regarding what to prioritise and demonstrate appropriate flexibility where needed.

38. A possible approach, and one which we think would be more effective in practice, would be to amend the two proposed new sentences at the start of Provision 15 to read: "*All significant director and non-director appointments should be listed in the annual report. The annual report should also confirm that there has been an annual assessment (potentially, but not necessarily, as part of the annual board performance review) that each director had, over the reporting period, sufficient time to undertake their role effectively in light of their time spent on commitments to other organisations, and describe any actions taken as a result of this assessment.*".

39. It would also be helpful to understand what is intended by the requirement to "*describe any actions taken as a result of this assessment*" – is it envisaged that the annual report should contain a statement that a director has been requested to, or has undertaken to, relinquish an external appointment if relevant? There are concerns about being required to make sensitive disclosures around having to reject (or relinquish) other appointments given their time commitments. It would also be helpful for Provision 15 to make clear whether the reference to an assessment is referring back to the assessment required by Principle K or any assessment carried out in order to be able to make the disclosure required by Provision 15.

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

40. Yes, we feel that the proposed changes to Section 3 of the Code broadly get the balance right, and we welcome the aim of seeking to ensure a coherent approach, but there are some instances of actual or potential duplication with the requirements under the Listing Rules in relation to diversity.

41. We note that Provision 24 refers to "*the gender balance of those in senior management and their direct reports*" whilst the new diversity provisions in the Listing Rules require disclosure of the "*gender identity or sex of the individuals on the listed company's board and in its executive management*" (LR 9.8.6R(10) and LR 14.3.33R(2)). These Listing Rule provisions also require disclosure in relation to ethnicity. Consideration should be given to aligning these requirements to avoid undue complexity in addressing multiple similar, but slightly different, reporting obligations, and so as not to be seen to prioritise gender over other diversity characteristics.

42. Additionally, we are not convinced that there is a need for additional reporting requirements in the Code, nor for additional guidance, given the existing reporting requirements in this area under s.414C(8)(c) of the CA 2006 and the Listing Rules.

43. Please also see the responses to Question 7 and Question 8.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

44. We welcome an approach which seeks to promote diversity in its broadest sense. Against this backdrop, we believe that the deletion of "*social*" in terms of background is a retrograde step. A person's social background is not a protected characteristic so is not covered by the other revisions and companies may lose sight of this as being a relevant factor when considering diversity. An alternative approach would be simply to include a broader and more generic reference to

promoting diversity, inclusion and equal opportunity rather than referring to any particular characteristics.

45. The references to "*protected characteristics*" seek to import provisions from English legislation which may not be applicable to all premium listed companies (in particular international issuers). If this term is retained in the Code then it may be helpful to include a glossary at the back of the Code which sets out what "*protected characteristics*" (and "*non-protected characteristics*") means to assist with disclosure for such companies.

46. We note the typographical error in footnote 6 where reference should be made to the Equality Act rather than the Equalities Act. We also suggest adding a comma after "*non-protected characteristics*" in Principle I (if this term is retained in the Code).

Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

47. As noted in our response to Question 6, we question whether the fourth bullet point of Provision 24 needs to retain the existing reference (currently in Provision 23) to the gender balance of those in senior management and their direct reports. The existing reference to gender balance was added to the Code in 2018 to address a recommendation of the Hampton-Alexander Review (November 2016). The FRC's consultation document in 2018 indicated this was intended to address inconsistencies in reporting by quoted companies on the gender of senior managers under s.414C(8)(c) of the CA 2006 (which requires quoted companies to disclose the number of persons of each sex who were directors of the company, senior managers (including directors of all subsidiaries included in the consolidation) and employees of the company in the strategic report).

48. However, since 2018 the FCA has amended its Listing Rules to require premium and standard listed companies to include in their annual reports:

- a statement as to whether the board has met certain specified board diversity targets regarding gender identity or sex (LR 9.8.6R(9) and LR 14.3.33R(1)); and
- standardised numerical disclosures relating to the gender identity or sex of their board, key board positions and executive management team (LR 9.8.6R(10) and LR 14.3.33R(2)).

(Unfortunately the definitions of "senior manager" in s.414C(9) of the CA 2006, "senior management" under the Code and "executive management team" under the Listing Rules do not directly align.)

49. In addition, there is already generally a high level of disclosure amongst the FTSE 350 against the recommendations set by the FTSE Woman Leaders Review (and historically the Hampton-Alexander Review) and also the Parker Review in relation to ethnicity. We also note that, in the fourth bullet of Provision 24, gender balance is focused on in a way that other characteristics are not. It does not seem particularly balanced to focus on one characteristic to the exclusion of others.

50. If the proposed changes to Provision 24 are intended to cater for companies which voluntarily adopt the Code, but which are not subject to the requirements of the UK Listing Rules, then it should at least be made clear that (in respect of all companies subject to the Listing Rules and the Code) compliance with the Listing Rules amounts to compliance with the Code in this particular respect.

51. We note that the focus of Provision 24 is much narrower than the new language in Principle I and question why this is the case. We suggest amending Provision 24 to require disclosure on board diversity in a broader sense, e.g. by referring to "*the diversity balance of those in senior management and their direct reports*". This would be consistent with the broader definition of diversity used in revised Principle I, and the references to diversity (not just gender balance) in Principle K, Provision 18 and the first three bullet points of revised Principle 24. The FCA's rules

already allow companies to include numerical data on the diversity of members of the board and the remuneration, audit and nomination committees (DTR 7.2.8CG).

52. Provision 24 also appears to include a new prescriptive requirement that companies must disclose succession planning "*in order to deliver the company's strategy*" – this may not be relevant for every listed company. The company may wish to change its senior management in order to initiate or further develop a change in the company's strategy, rather than to deliver its existing strategy. Furthermore, we assume that it is not intended that there should be disclosure of actual succession plans given the inherent sensitivity and confidentiality attaching to any such plans? Assuming that is the case, then there is a risk that disclosures against this aspect of Provision 24 will be generic and formulaic in nature. Accordingly, we think that the words "*in order to deliver the company's strategy*" can be deleted without impacting how companies consider succession planning.

53. In addition, the requirement regarding reporting on gender balance which has been included in Provision 24 is distinct from the requirement to provide a description of the work of the nomination committee which is the focus of Provision 24. Whilst recognising that this is within the current Provision 23, we suggest that this reporting and disclosure requirement should be located elsewhere in the Code or omitted given the overlap with the requirement under the Listing Rules referred to above.

54. Footnote 7 defines "*senior management*" for the purposes of the fourth bullet point of Provision 24. It should be made clear whether this definition also applies where the phrase 'senior management' is used in Provision 18 and the first and second bullet points of Provision 24. For example, this might be achieved by amending footnote 5 to read: "*The definition of 'senior management' for the purposes of the Code should be the executive committee or the first layer of management below board level, including the company secretary*". It would then not be essential to repeat this footnote every time the phrase 'senior management' is used.

Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

55. We welcome guidance from the CGI and any additional guidance from other expert bodies. However, it is important that guidance from different sources is joined up (with the Code and other relevant guidance) so that a consistent approach is taken. Accordingly, we welcome the FRC's approach (described in paragraphs 34 and 35 of the Consultation Document) of reviewing the CGI guidance and amending the Code and the FRC's guidance as appropriate. It would also be helpful to companies if any relevant guidance produced by bodies other than the FRC is adopted/endorsed by the FRC if not incorporated in the FRC's own guidance so that companies can be comfortable that in following it they will be meeting the Code's requirements.

56. We also agree with the FRC's proposal to use the term "*board performance review*" instead of "*board evaluation*" in the Code.

57. As a practical point, it would be helpful for the guidance to confirm whether any flexibility is incorporated into the requirement in Provision 22 to have an externally facilitated board performance review every three years. Due to the relatively limited availability of external evaluators, a number of companies do not technically conduct the review within the required three year period, and will often conduct it within the three months or so after the year end, but before the annual report is published. This enables them to report on the outcome of the review in the annual report published three years after the last external review was reported on. It would be helpful to have clarification that this practice does not give rise to any requirement to 'explain' this minor technical non-compliance.

Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

58. As a general comment on the changes made to Section 4 of the Code, we noted in our response to Question 3 that the board's role is primarily to provide strategic leadership and high-level oversight, and under Provision 25 (existing Provision 24) the members of the audit committee should all be independent non-executives, not full-time employees. Accordingly, there is a risk that some of the proposed changes to Section 4 of the Code ask the board and/or the audit committee to do more than provide oversight, and instead require them to undertake certain tasks which are arguably not within their remit. In particular, certain of the proposed revisions would seem to envisage that some executive and management responsibilities (e.g. continuous oversight) would, going forward, sit with the board as a whole. This is arguably an inappropriate extension of the supervisory role of the non-executive directors and would further impact the time commitment required by directors to discharge their responsibilities (which potentially feeds back into concerns with regard to Provision 15).

59. By way of example, the new fourth and eighth bullet points of Provision 26 require the audit committee to "*implement*" (not just develop and periodically review) the audit and assurance policy, "*implement*" (not just develop and periodically review) the policy on the engagement of the external auditor, and "*ensure*" there is prior approval of non-audit services (not just provide periodic oversight of the approval process). We consider that it is not appropriate to expect the board and the audit committee to provide real-time continuous oversight or supervision of operational or compliance activities.

60. We do not object to the principle of extending the proposed new obligation for the directors' report of certain UK companies to include an audit and assurance policy statement to all premium listed companies on a 'comply or explain' basis (see proposed s.416A of the CA 2006 to be added by the draft Companies (Strategic Report and Directors' Report) (Amendment) Regulations 2023) (the "**draft 2023 Regulations**"). However, this Code requirement should more closely track the obligation imposed by the draft 2023 Regulations. Accordingly (and also for the reasons given above), we consider the word "*implementing*" should be deleted from the new fourth bullet point of Provision 26.

61. Proposed new footnote 11 to the Code requires companies which are not subject to the draft 2023 Regulations to "*determine the content of their [audit and assurance] policy taking this regulation [i.e. proposed s.416A of the CA 2006] into account*". This will require such companies (e.g. those incorporated overseas) to look at the CA 2006 and any related guidance, and probably obtain legal advice, to understand their 'comply or explain' obligations under the Code. We are not sure this is the right approach. It is inconsistent with the drafting principles underlying the Code (i.e. succinct, plain English provisions which non-lawyers can understand). It may be better if the FRC distilled into succinct, plain English the key elements of the new s.416A of the CA 2006 which the FRC considers all premium listed companies should be subject to, and set these out in a Code Provision, a footnote, or guidance. See also our comments on international companies in Part A of this response.

62. In our view the fifth bullet point of Provision 26 should be amended to begin: "*seeking to engage with shareholders and other stakeholders…*" This is for the same reason that we proposed amending Provision 3 in our response to Question 3; that is the audit committee can only engage if shareholders are willing to make time to speak with them.

63. The proposed changes to the Code will result in an increase in the burden placed on audit committees. In particular, we note the deletion of the reference to "*financial*" in new Provision 30 and consider that the controls to be monitored and reviewed by the board will result in significant additional internal assurance work and an expansion in the scope of work to be undertaken by an audit committee. Not all of this work may necessarily be appropriate for the audit committee, as some aspects of this may be the responsibility of other board committees such as a risk committee, whilst some aspects may require significant input from management. Please also see the response to Question 15.

64. We also consider that the requirement in Provision 30 for the board to provide a declaration on the effectiveness of the company's risk management and controls in the annual report needs to be considered carefully in conjunction with the FCA's Listing Principle 1 ("*A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations*" – LR 7.2.1R). There is a risk that any disclosure of a lack of "*effective*" controls (whether or not remedied or within the control of the company) will mean that a company could be self-reporting breaches of Listing Principle 1 in its annual report. While companies should consider whether any such disclosure is required (for example, under the UK Market Abuse Regulation or otherwise), it may be that the Code is not the appropriate method to require this disclosure. Additionally, this may result in companies taking a narrow and conservative approach to disclosure which is unlikely in practice to achieve the increase in outcomes-based disclosure that the revisions to the Code are seeking to achieve.

65. We also note the difference in language between Listing Principle 1 which requires listed companies to establish and maintain "*adequate procedures, systems and controls*" and the requirement of Section 4 of the Code which refers to an "*effective*" risk management and control environment (as set out in new Principle N and Provision 30). It would be helpful to understand whether the requirements in Section 4 are designed to require companies to reach a higher standard than that set out in Listing Principle 1 and/or what is the level of tolerance in considering what is 'effective' as opposed to 'adequate'. Guidance on this point would be helpful, in particular as to any thresholds beyond which boards should consider their controls are not effective – for example, presumably boards should not be required to report non-material breaches or the failure of such controls that have been remedied without there having been any significant consequence as a result of such breach or failure? Please also see the responses to Questions 14 and 16.

66. From a practical perspective it will be difficult to report "*up to the date of the annual report*" (as proposed in the first bullet point of Provision 30) and instead this should either be to the end of the financial year, or to an appropriate practical cut-off date prior to publication of the annual report and this date should be specified in the annual report. See also the response to Question 14 below.

67. We do not believe that it should be a prescribed part of the role of the audit committee of a listed company to support audit market diversity (as required by the seventh bullet point of Provision 26). Indeed this could go beyond the duties of a director under section 172 CA 2006 (to promote the success of the Company) and potentially require them to act for a collateral purpose (i.e. a purpose inconsistent with their duties under section 171(b) of the CA 2006). Identifying what actions (if any) the audit committee may need to take during the tendering process to support audit market diversity would require the committee to monitor the level of diversity in the audit market, assess the potential impact of different actions the committee could take, and act in a manner that supports diversity. The audit committee is poorly placed to conduct this assessment. This could leave the audit committee uncertain as to whether it has fully complied with Provision 26. Accordingly, we would suggest deletion of the requirement in new Provision 26 for the audit committee to promote effective market competition during the tendering for any external auditor.

68. We also note that the obligations on FTSE 350 companies in relation to external audit tendering are already contained in the FRC's Minimum Standard for Audit Committees (the "**Minimum Standard**").

Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

69. We agree that referring to the Minimum Standard is an effective way of removing duplication, however we note that the standard is not yet mandatory and there remain a number of concerns around the standard as drafted. Those concerns were highlighted in our response to the FRC dated 3 February 2023 that was submitted in the context of the earlier consultation on the Minimum Standard (at https://www.citysolicitors.org.uk/storage/2023/02/CLLS-CLC-response-to-FRC-consultation-in-respect-of-the-Draft-Minimum-Standard-for-Audit-Committees-03-02-23.pdf).

70. We were disappointed that the concerns raised were not even acknowledged in the feedback published alongside the final form of the Minimum Standard. We continue to be of the view that the concerns raised merit further consideration. Furthermore, how is the concept of "comply or explain" intended to apply to the provisions of the Minimum Standard if and when it becomes mandatory?

71. This notwithstanding, some of the provisions added are duplicative of matters already in the Minimum Standard in paragraphs 4, 7 and 14. We would suggest that the FRC considers any such duplication as part of any revisions to the Code.

Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

72. Our understanding is that companies are adopting a variety of governance structures to oversee narrative reporting and, in particular, non-financial reporting including sustainability and climate-related reporting. In some cases, the responsibility for having oversight is spread across a range of committees, some of which may be formal board committees such as the audit committee or the risk committee but in other cases this may be delegated to separate ESG or sustainability committees.

73. Accordingly, and as stated further below, we do not consider that Provisions 26 and 27 should oblige the audit committee to take responsibility for narrative reporting. Furthermore, we do not support the proposal that sustainability and ESG metrics should be specifically identified for monitoring and reporting on by the audit committee. A specific reference to these matters and metrics suggests that they are more important and should warrant increased focus as compared to other aspects of narrative reporting, which we do not believe should necessarily be the case for all companies. The relative importance of particular aspects of narrative reporting to a particular company is likely to be driven by the circumstances of the company, the specifics of the business and the nature of its stakeholders. Even allowing for the references to "*including*" and "*where appropriate*", the very fact that these matters are specifically referenced is likely to result in an expectation that these should fall within the remit of the audit committee.

74. In addition, to put responsibility for all narrative reporting on the audit committee would considerably expand the role and responsibilities of the audit committee and would (in our view) be misplaced. We consider the board is best placed to determine what should be the roles and responsibilities of its committees (for example, possibly by constituting a separate HSE, risk, ESG and/or sustainability committee) and such decisions should be left up to the board. For example, it is not clear that listed company boards have mandated their audit committees to take responsibility for disclosure against the TCFD framework, let alone broader (undefined) ESG metrics. Accordingly, the Code should continue to allow for maximum flexibility in this regard and in our view these proposals should not be adopted.

75. We also do not think that the third bullet point of Provision 27 should specifically highlight the assurance of ESG metrics and other sustainability matters. Narrative reporting addresses a wide variety of matters, and their relative importance will vary depending on the sectors and regions in which the company / group operates, the specifics of its business, its size and its stage of development. The board is best placed to identify those matters of greatest relevance to the company, and what (if any) assurance the company should obtain regarding these. We think that the Code should not seek to limit the board's flexibility by suggesting that certain matters are more appropriate candidates for assurance than those identified by the board.

76. Companies are already required under Principle N (Principle M in the draft revised Code) to present a fair, balanced and understandable assessment of the company's position and prospects. Most companies will typically put in place a series of internal controls as part of the process for preparing their annual report and accounts, to enable the board to conclude that the annual report and accounts are fair, balanced and understandable. This and other obligations will guide the board in ensuring that relevant matters are properly considered and the appropriate assurance obtained. In

our experience the internal controls around this process vary and we would encourage the FRC or the CGI to publish relevant guidance, albeit any such guidance should allow for different approaches consistent with a proportionate approach to this task.

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

77. See the responses to Questions 10 and 14.

78. We have received feedback indicating that many companies anticipate that the proposed changes will result in the need to devote considerably greater resources both in terms of time and cost to the process of reporting and the related assurance activities (whether or not external assurance is a specific requirement). This additional cost of reporting may have the effect of reducing the investment that can be made in the risk management and internal control systems themselves. We note that the FRC does not appear to intend undertaking an impact analysis in relation to the proposed changes to the Code and, in particular, the changes to Section 4.

Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

79. We have concerns that the requirement for the board to provide a declaration in the form proposed will result in companies having to devote significant resources in terms of time and costs to the underlying verification and assurance process in order for the directors to be comfortable that they can do so.

80. We have the following comments on the proposed form of the declaration as set out in Provision 30:

- The board's declaration should be based on the date of the balance sheet or up to an appropriate practical cut-off date ahead of publication of the annual report. As noted in the response to Question 10, we believe it is not appropriate to expect the board to continuously monitor and provide continuous oversight (which is the role of executive management) up to the annual report date and obliging boards to do so would place a disproportionate burden on them.

- The removal of the reference to "*financial*" and its replacement with "*reporting*" has the effect of broadening the ambit of the statement beyond even what is addressed in a Sarbanes-Oxley reporting environment.

- It is unclear what is intended by the reference to concluding whether the relevant systems have been "*effective throughout the reporting period*". Do minor failings that have been corrected/addressed without any significant consequence need to be reported or should the focus be on only material weaknesses or material failures? The third bullet in Provision 30 would suggest it is the latter but the first and third bullet are arguably contradictory in that regard.

- Equally if a material weakness were to have been identified, then clearly this should be described along with the remedial action taken or to be taken (as required by the third bullet point of Provision 30). Disclosure of this kind should not prevent the directors providing a declaration that the relevant systems are effective as at the date of the declaration (if that is the case) but it is not clear that is permitted in light of the wording in the first bullet. This should be clarified.

81. See also the response to Question 10 in relation to the difference between "effective" as proposed here and "*adequate*" in the FCA's Listing Principle 1. We think the FRC's intentions regarding the

first bullet point of Provision 30 would be better reflected if this bullet point read as follows: "*A declaration by the board that it has reasonably concluded that the company's risk management and internal control systems have been effective throughout the reporting period, or a statement that such a declaration is unable to be given.*".

Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

82. Please see the discussion of Provision 30 in our responses to Question 10 and Question 14.

83. We are of the view that the required controls over reporting should be limited to financial, operational and compliance controls. Without this limitation the scope of the board's responsibility in relation to reporting controls would be too wide, result in disclosure that is not informative and/or result in a lack of clarity given the overlapping reporting requirements imposed by other legislation, regulation and guidance. In particular, extending Provision 30 to require the board to monitor and review all material "*reporting*" controls (including controls relating to narrative reporting) would very significantly expand the responsibilities of the board. This would extend the board's responsibilities into executive and management areas which fall outside its proper role (as noted in our response to Question 3).

84. We also note the requirements of Listing Principle 1 (as considered in the responses to Question 10 and Question 14) which already imposes obligations as regards the broader controls framework for premium listed companies.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

85. As a general comment we would be supportive of guidance being prepared. The methodologies and frameworks included in the guidance should be suggestions rather than mandatory and a number of different methodologies and frameworks should be provided to prevent companies following only one suggested framework and methodology (which is unlikely to be suitable for all companies). Any guidance should include considerations/explanations around when a board can reasonably conclude that a particular system was effective (for example, if there is one breach which was remediated or is in the process of being remediated and this has not given rise to any significant consequence then arguably this does not that mean that the controls as a whole are not effective) and this needs to be tied to the definition of "*material weakness*". Effectiveness also needs to be defined in a way that works for both small and large companies (as larger companies will have more complex processes). Without clear guidance there are concerns that companies may over report (i.e. any and all breaches) or under report because they take the view that certain operational mistakes are not material weaknesses.

86. As noted in the response to Question 10, there is a potential misalignment between the requirement in the FCA's Listing Principle 1 (requiring "*adequate systems, controls and procedures*") and the need under Principle N and Provision 30 to evaluate the effectiveness of the systems (and why the board considers the relevant framework or standard to be appropriate for the company's circumstances). Any relevant guidance should also take into account such overlapping requirements.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

87. We believe that there may be other respondents to the Consultation Document who are better placed to answer this question. However, guidance should be provided as to what "*effective*" means and what is the scope of a risk management system and an internal controls system. See also the response to Question 16 regarding the definition of "*effectiveness*".

88. For example, the proposed definition of "*material weakness*" on page 21 of the Consultation Document should incorporate a materiality standard (in the context of the issuer) to ensure that minor breaches or weaknesses that did not have, or did not have the potential to have, a material consequence are not captured or given undue prominence.

89. The proposed new footnote 12 to the Code says that "*emerging risks should include those whose impact and probability are difficult to assess and quantify at present, but there is a reasonable probability of affecting the company over a longer time horizon*". This definition seems to capture any risk with uncertain impact and likelihood and a reasonable probability of 'affecting' the company, even if the effect is likely to be minor (e.g. the risk that a key executive will need to take a day's sick leave in future). We think this definition should also include some sort of materiality threshold, so that the board is not required to assess and manage immaterial risks under Provision 29.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

90. We note that the second bullet point of Provision 26 includes a reference to sustainability matters as specifically identified items to be considered as part of the monitoring of narrative reporting. Without prejudice to the views expressed in the responses to Question 12 and Question 15, this is an example of where the Code would require reporting to focus on one area that may impact a company's reporting without regard to other potential areas that may have a more significant impact on such reporting.

Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

91. We do not see any issue with its retention, particularly as it is on a comply or explain basis, but we would suggest that appropriate guidance be provided as regards the requirement for resilience statements to be provided by companies which are not subject to the draft 2023 Regulations.

92. Paragraph 72 of the Consultation Document says that companies which comply with the going concern element of proposed s.414CD(7) of the CA 2006 (to be added by the draft 2023 Regulations) will also comply with Provision 31. This should be recorded in FRC guidance. Given the differences in the wording of the two requirements, this point may not be obvious to companies (who should not need to refer back to the Consultation Document to understand their obligations) - see our earlier comments in Part A of this response around the need for clarity of reporting and minimising duplication (of which this is one example).

Q20: Do you agree that all Code companies should continue to report on their future prospects?

93. We agree that all Code companies should continue to report on their assessment of the company's future prospects.

94. We would prefer that Provision 32 (existing Provision 31) is retained in its existing form and that the proposed changes to it are not made. We understand the FRC's desire to extend something like the resilience statement requirement to all premium listed companies on a 'comply or explain' basis. In our view, the simplest and clearest way to achieve this is to retain Provision 32 (existing Provision 31) in its current form. Companies subject to the Code are already familiar with this wording and what it requires.

95. The proposed new resilience statement required from certain UK companies must, among other things, "*provide an assessment by the directors of the company's prospects and of the likelihood that the company will continue in operation and meet its liabilities as they fall due over the medium-*

term" (see proposed s.414CD(8) of the CA 2006 to be added by the draft 2023 Regulations). This requirement differs from revised Provision 32 in two important ways:

- Companies are given flexibility to define the "medium-term" for the purposes of the new resilience statement (see proposed s.414CD(4) of the CA 2006). Existing Provision 31 also allows the board to define the period over which to conduct its assessment of the company's prospects. However, this flexibility is missing from revised Provision 32 (which requires an assessment of "*future prospects*" over an undefined period).

- In the new resilience statement the directors are only required to assess the "*likelihood*" that the company will meet its future liabilities, not its "*ability*" to meet them (as required by revised Provision 32). Assessing "*likelihood*" requires assessing probabilities over a spectrum (from at least 'likely' to 'not likely'), and implicitly recognises that 'likely' events may not happen. Similarly, existing Provision 31 requires the board to state whether it has a "*reasonable expectation*" that the company will be able to meet its future liabilities. Assessing "*ability*" is more binary – a company is either able or unable to meet its liabilities. It is not appropriate or realistic to ask the board to provide a statement of fact/unqualified representation about the ability of the company to meet its future liabilities. The directors may be exposed to legal liability if this proves incorrect, even if this is due to events that lie far outside mainstream expectations.

96. Alternatively, the proposed revised wording of Provision 32 should be amended to more closely mirror the requirements of the new resilience statement. Either approach should ensure that the board: (a) is given flexibility to define the period over which to conduct its assessment of the prospects of the company; and (b) is only required to state whether it has a "*reasonable expectation*" that the company will be able to meet its future liabilities, or alternatively only give its assessment of the "*likelihood*" of this (not the company's "*ability*" to meet its liabilities).

97. Paragraph 76 of the Consultation Document says that companies which comply with the resilience statement requirements of the draft 2023 Regulations will also comply with revised Provision 32. This should be recorded in FRC guidance, for the same reasons as discussed in our response to Question 19.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

98. The focus on English law requirements may result in a lack of clarity on the disclosure that is expected to be made by companies incorporated outside of the UK. See our comments on international companies in Part A of this response. This issue can be avoided if Provision 32 (existing Provision 31) is retained in its current form, as suggested in our response to Question 20.

99. Proposed new footnote 14 to the Code requires the boards of companies which are not subject to the resilience statement requirements of the draft 2023 Regulations to "*report in a similar and proportionate way to the requirements of this section [i.e. proposed s.414CD of the CA 2006] or set out the basis for the assessment in the annual report*". Such companies will be required to refer to the CA 2006 and any related guidance, and probably obtain legal advice, to understand their 'comply or explain' obligations under the Code (see our comments on proposed new footnote 11 discussed in our response to Question 10, which raises a similar issue). Although such companies should still have sufficient flexibility given the ability to explain how they report on their future prospects, it would be useful for the FRC to provide guidance to help prevent boilerplate reporting.

Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

100. The concerns raised in Part A in this response about changes being made to Principles of the Code (which companies must apply), as opposed to Provisions (against which companies have the option of 'comply or explain'), are relevant to the proposed changes to the Principles in Section 5. There also appears to be unnecessary duplication (and/or an inconsistent approach) between

Principles O and P, in that Principle O requires that "*remuneration policies and practices should be designed to support strategy and promote long-term sustainable success*" and Principle P requires that they align to the successful delivery of long-term strategy.

101. There are also some elements of the revisions to Principles O, P and Q which appear to be overly prescriptive from a corporate governance perspective. In particular, we note revised Principle P will require a company to align their remuneration outcomes to the successful delivery of the company's long-term strategy including with ESG objectives. In our view it should be up to individual companies to decide what aspect(s) of their long-term strategy their remuneration outcomes should be linked to. Companies should comply or explain against their own objectives. If the proposed new language is included in the Principles rather than the Provisions, companies could view the requirement to link remuneration outcomes to ESG objectives as mandatory. The Code applies to different companies, in different industries, of differing sizes, operating in different jurisdictions and at different stages in their development, therefore the Code needs to allow flexibility for different approaches.

102. If the proposed new drafting in Principle P is not removed then we consider it should be amended to read "*the successful delivery of the company's long-term strategy (including any relevant environmental, social and governance objectives)*".

103. Existing Principle O states that "*Executive remuneration should be aligned to company purpose and values…*". However, this has been changed in revised Principle P to "*Remuneration outcomes should be clearly aligned to company performance, purpose and values…*". We presume that the "*remuneration outcomes*" mentioned in revised Principle P only relate to executive remuneration (consistent with revised Principle O and the limits on the remit of the remuneration committee under Principle 34), not to remuneration of the wider workforce. To address this point and also our comments on Provision 34 below (which make an additional suggestion regarding the wording of Principle P), we recommend amending Principle P to begin "*The remuneration framework for executives [or "directors and senior management"] should be clearly aligned…*".

104. In revised Principle Q, we note that the remuneration committee must take into account certain matters including workforce pay and conditions when authorising remuneration outcomes. There is uncertainty about what "*workforce pay and conditions*" means, especially for companies with broad international operations that may not have a single set of workforce pay and conditions. As noted above, having this language included in a Principle, rather than the Provisions, may be considered to be prescriptive. We do not think it is necessary to have a specific factor that addresses workforce pay and conditions, but suggest that it is included as something that the directors have regard to in their final determination of remuneration. Workforce remuneration is also addressed in Provision 35 and given this is subject to 'comply or explain', the reference in Principle Q to workforce pay and conditions is unnecessary and duplicative.

105. Provision 34: we do not consider that it is correct or appropriate to say that the remuneration policy should "*ensure outcomes*". The remuneration policy should provide the framework in which the board and the remuneration committee can structure the remuneration package and resulting outcomes; the policy cannot of itself ensure the outcome. We would suggest that the drafting could be revised, replacing "*ensure outcomes are*" with "*provide a framework capable of facilitating outcomes that are*". Similarly, as noted above we would suggest that the reference in Principle P to "*Remuneration outcomes*" should be changed to "*The remuneration framework*" as it is the framework that should be aligned to performance, purpose, values and strategy.

106. Provision 35: we suggest further clarification is provided around what is expected in relation to the requirement to provide an "*explanation of the company's approach to investing in and rewarding its workforce*". Does this reference to "*investing in….its workforce*" include training or other non-financial benefits? Does this involve setting out what the company's pay policy is or what the levels of contribution to pension schemes are? There are also concerns that this may require a company to disclose sensitive details of its pay policy, which may put it at a competitive disadvantage.

107. Provisions 35, 41 and 43: if Principle Q is not amended as we suggest above and the remuneration committee is obliged to take into account "*workforce pay and conditions*" when authorising remuneration outcomes, then the different language used in Provisions 35 ("*workforce remuneration and related policies*" and "*the company's approach to investing in and rewarding its workforce*"), 41 ("*pension contribution rates… available to the workforce*" and other pension-related "*workforce arrangements*") and 43 ("*overall company pay policy*") should be revised to ensure consistency between the Principles and the Provisions.

108. Finally, companies may well need to amend their remuneration policies in order to comply with the proposed changes to Section 5 of the Code. This will take time, as UK companies are only obliged to put their remuneration policy to a shareholder vote once every three financial years (s.439A of the CA 2006). It would be helpful if the FRC issued guidance to the effect that the revised Section 5 of the Code only applies to companies with effect from the AGM at which their remuneration policy is next due for a vote.

Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

109. It is helpful that Provision 39 is proposed to be amended to clarify that documents covering director remuneration should include malus and clawback provisions that would enable the company to recover and/or withhold sums or share awards. We believe that this explicit requirement will encourage transparency. However, we question why the last sentence of Provision 40 requires companies to set out the use of their malus and clawback provisions for the last five years given past annual reports disclosing this information will be publicly available. The third bullet of Provision 40 and paragraph 83 of the Consultation Document only require companies to disclose whether malus and clawback provisions have been used in the last reporting period. That seems a better approach. We suggest that the disclosure to be set out in the annual report is limited to the current financial year (and if this is considered insufficient then also the previous financial year). We also suggest that either guidance is provided on what is meant by "*other agreements or documents which cover director remuneration*" in the second sentence of Provision 39, or these words are replaced with "*remuneration schemes and policies*" (consistent with the first sentence of Provision 39).

110. Provision 40 sets out the enhanced malus and clawback disclosure requirements, which aim to achieve greater transparency. This disclosure is required to appear in the annual report on remuneration (i.e. the company's <u>directors'</u> remuneration report under CA 2006). The Consultation Document indicates that the disclosure would be limited to the way malus and clawback <u>apply to directors</u>. In particular, paragraphs 80 and 81 refer to executive director remuneration and withholding pay "*from directors*". Provision 39, to which the Consultation Document refers expressly, is clearly limited to directors' pay.

111. However, Provision 40 does not mention directors' pay. There is no obvious link or cross referencing between Provisions 39 and 40, apart from the fact that they follow each other. Provision 39 sets out the requirement for director contracts etc. to include provisions enabling "*the company to recover and/or withhold sums or share awards*". Provision 40 sets out what a company should describe in its annual directors' remuneration report, presumably to show compliance with the requirements of Provision 39, but Provision 40 refers only to malus and clawback provisions, without an express link to director pay. Read in isolation, Provision 40 might be thought to have broader application (i.e. a requirement to describe the company's malus and clawback provisions and usage for the board <u>and</u> the wider workforce).

112. In view of this and in the current environment, it seems prudent to clarify the precise ambit of the disclosure requirements of Provision 40. We assume that the intention is to limit the disclosure to the malus and clawback for executive directors' pay, rather than more broadly to workforce pay and, if so, this should be expressly reflected in Provision 40.

Q24: Do you agree with the proposed changes to Provisions 40 and 41?

113. We assume that revised Provision 43 (existing Provision 41) is intended to be focused solely on executive director remuneration (rather than non-executive directors and senior management remuneration). This would be consistent with revised Principle O and the limits on the remit of the remuneration committee under Provision 34. In the existing Code, existing Provision 41 is also preceded by Provision 40 (to be deleted), which refers to executive director remuneration and so helps to set the context for the following provision. We suggest that the drafting of the second, third and fourth bullets of Provision 43 is amended to make this limitation clear (i.e. so that they refer to executive director remuneration policy and outcomes, not remuneration policy and outcomes). Please also see the response to Question 23.

114. We note that there are three factors which the remuneration committee is currently required to address (in existing Provision 40) which are not included in the revised drafting in Section 5, namely reputational and other risks from excessive awards, predictability and simplicity. These are important factors which we suggest remuneration committees should continue to have to address when determining executive director remuneration policy and practices. These could be added to Provision 34 which already addresses risks (which presumably includes reputational risk), clarity and proportionality.

115. In revised Provision 43, we do not believe that it is appropriate for the Code to require companies to say that remuneration of executives should be (in part) tied to ESG outcomes (see also the comments in relation to Principle P in our response to Question 22). It should be left up to the company to determine its strategy and key objectives (in light of its circumstances, the specifics of its business, and any relevant considerations in determining how to act in the best interests of shareholders, such as those contemplated by Section 172 of the CA 2006). If shareholders want to see greater alignment between ESG and remuneration, they can provide their views through engagement and voting in relation to a company's remuneration policy. We believe that the Code should be the place to promote good governance behaviour not to promote any particular agendas which may evolve over time.

Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

116. We note that gender pay gap reporting is required under the Equality Act (Gender Pay Gap Information) Regulations 2017 and the Government has recently published voluntary guidance for employers regarding ethnicity pay gap reporting (April 2023). For this reason, we do not feel that this needs to be addressed in the Code. Accordingly, we agree with the FRC's proposal to remove the references to pay gaps contained in existing Provision 41 (to become Provision 43). However, if there are any categories of pay gap reporting which are thought not to be adequately dealt with elsewhere then we do not see any issues with the FRC providing guidance on this.

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

117. As noted in the Consultation Document, the Government published a White Paper on artificial intelligence regulation in March 2023. Until such time as Government policy on artificial intelligence is more developed, it is difficult to determine what additional amendment or guidance is needed (or could be usefully provided) in this area. Any such amendment or guidance could quickly become outdated or inaccurate. If companies consider that artificial intelligence is a risk to their business, then that will be factored into the determination of their emerging risks and principal risks and uncertainties and disclosed accordingly. It should also be noted that artificial intelligence is just one of a number of potential technology related risks that companies may face now or in the future (such as cyber-attack risks) and we see no merit in calling out one aspect (no matter how topical at the present time) in isolation. Accordingly, we do not consider that any changes are needed in this area. We do however support the FRC keeping developments in this area under review.

FOR FURTHER INFORMATION PLEASE CONTACT:

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