New Corporate Governance Code

The Financial Reporting Council has put out for consultation a Revised UK Corporate Governance Code (responses are due by 28 February 2018), with a paper describing the Proposed Revisions and the thinking behind them, and a Summary of Changes showing where current provisions appear in the new Code. There is also Revised Guidance on Board Effectiveness, setting out good practice to assist companies in applying the Code. Following the consultation, a final version of the Code is due in early summer. The changes will apply to accounting periods beginning on or after 1 January 2019, so a company with a 31 December year end will need to report on the application of the new Code in its 2019 annual report and at its 2020 AGM. As before, the Code applies to all companies with a premium listing, wherever incorporated.

The new Code is described as “shorter and sharper” than its predecessor and, at 13 pages, is indeed half the length. There is a new two tier structure of high level Principles and more detailed Provisions, with the Supporting Principles from the current Code either reassigned between those two categories, deleted or demoted to the Board Effectiveness Guidance. The FRC has said the focus should now be on “outcomes not processes”, with the emphasis on describing how the Principles are applied, rather than a tick box approach to the Provisions. For that wish to come true, both investors and their voting advisors and companies and their annual report writers will have to buy-in to the message. The existing regulatory scheme continues to apply: the annual report must describe, in a manner that shareholders can understand, how the Principles have been applied; and it must say whether the Provisions have been complied with, or, if not, explain why (Listing Rule 9.8.6(5) and (6)).

There is a new look and feel to the revised Code, though some of the old wording survives. Here is a summary of the main changes (more analysis can be found here).

• **Employee engagement** – following the lead from Government in its August 2017 reform proposals, new Provision 3 requires a board to establish a method for gathering the views of the workforce. This would “normally” be a director from the workforce, a formal workforce advisory panel or a designated non-executive director (or any combination thereof). Note the term “workforce” – this has been deliberately used to include “all those paid to work for the company”, including agency workers and self-employed contractors, not just those with formal employment contracts. The annual report will need to explain this engagement and how the “stakeholder factors” in s 172 Companies Act 2005 have influenced the board’s decision-making.

• **Diversity** – the current Code requires board appointments to be made “with due regard for the benefits of diversity, including gender”. The new Code is more specific: appointments and succession plans for the board and senior management should “promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths” (Principle J). The annual report should detail the gender balance among senior management and their direct reports.

• **Culture** – a company’s culture is a major theme of the new Code: “Directors should embody and promote the desired culture of the company” (Provision 2). That culture must be monitored and assessed to ensure that behaviour throughout the business is aligned with company values. The annual report should explain how the board achieves this.

• **Chair and independent NEDs** – the new Code includes the Chair as one of the independent non-executive directors who, together, should form a majority on the board (Provision 11). The current Code raises a presumption that a NED is not independent if any of seven tests of independence is failed; the new Code retains those tests, including nine years’ service on the board, but toughens their effect by saying a defaulting NED should not be considered independent (Provision 15). That may have the effect of calling time on a number of long-serving Chairs, although a board can still explain why it disagrees.

• **Smaller companies** – all the exemptions for companies outside the FTSE 350 will go in the new Code. Smaller companies, like their larger brethren, will need a board with a majority of independent non-executive directors. All directors will have to stand for re-election each year and an externally facilitated board evaluation will be needed every three years. Each board committee should have at least three directors. These reforms will be expensive for those companies least able to afford the extra cost.

• **Shareholder opposition** – the requirement to respond to significant votes against a resolution at a general meeting is enhanced in the new Code. “Significant” is now translated as more than 20%. The board will have to explain, when announcing the result, what action it intends to take to consult shareholders in order to understand the reasons for the vote. In addition, an update should be given six months later, with a final review in the following year’s annual report or AGM notice (Provision 6). The Investment Association has started to keep a register of these responses, with 22% of all FTSE companies caught by the criteria.

• **Remuneration** – the chair of a remuneration committee should have at least a year’s experience on a remco before appointment (Provision 32). The committee will now set pay for the board and senior management (the executive committee or the first level below the board, including the company secretary), and have oversight of “remuneration and workforce policies and practices” (Provision 33). The FRC acknowledges that delegation to other committees may be necessary to cope with this increased workload. The remco should retain the ability to override outcomes on remuneration that don’t reflect actual performance (the recent example of Persimmon and the CEO’s £100m LTIP bonus is a case in point).

Other News

• **AIM Rules Review** – the London Stock Exchange is consulting on proposed changes to the AIM Rules, including a requirement in the Rule 26 disclosures for AIM companies to comply or explain against a recognised governance code. Our note explains further.

• **Sexual harassment** – the Equality and Human Rights Commission has written to Chairs of FTSE100 companies and other leading employers asking what safeguards they have in place to prevent sexual harassment, what they plan to do in future and what whistleblowing facilities they have. Where there are systemic failings, the EHRC may take enforcement action. Responses are required by 19 January 2018. Guidance on the law can be found here.

• **Senior accounting officers** – HMRC last year fined 115 SAOs, usually finance directors, up to £5,000 each for failing to maintain adequate tax accounting arrangements or omitting to disclose related deficiencies to HMRC. See our article here.

• **Thomson Reuters Company Secretary Forum** – a note on the proceedings at this event can be found here, with some valuable insights from the day.

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If you would like further information, please get in touch with your usual Pinsent Masons contact, or with Martin Webster.