Bird & Bird & Capital Markets Group: PLC Update

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The UK Corporate Governance Code 2018

Following on from the Financial Reporting Council's ("**FRC**") consultation on its proposed changes to the UK Corporate Governance Code in February this year (the "**Consultation**"), the FRC published its final version of the new code on 16 July 2018 (the "**Code**"). The Code applies to all companies with a premium listing, whether incorporated in the UK or elsewhere. The Code applies to accounting periods beginning on or after 1 January 2019, although the FRC has indicated that companies may choose to adopt all or part of the Code from an earlier date. A meaningful assessment of how companies have chosen to interpret the Code is unlikely to be possible until 2020.

One of the FRC's key aims under the Consultation was that the Code be condensed. That has been achieved and the Code is a more concise version than its predecessor. It now consists of 18 Principles and 41 corresponding Provisions.

The Code is divided into five sections:

1. *Board Leadership and Company Purpose.* The Principles focus on the board and its relationship with shareholders and the workforce and how this contributes to a company's long-term, sustainable success.

2. *Division of Responsibilities.* The Principles reflect well understood concepts regarding independence and clear division of responsibilities to ensure that the board remains effective and encourages open and constructive discussion.

3. *Composition, Succession and Evaluation.* The Principles require formal, rigorous and transparent procedures, focusing on composition, gender, social and ethnic diversity, length of service and a mix of skills and experience. This applies to the composition of the board, as well as senior management.

4. *Audit, Risk and Internal Control.* The Principles reiterate the importance of formal and transparent policies and procedures, independence and effectiveness of internal and external audit functions to preserve the integrity of financial statements and risk strategy.

5. *Remuneration.* The Principles focus on the importance of remuneration policies and practices which support the company's strategy and promote long-term, sustainable success.

The key changes made by the Code are as follows.

The Company, Shareholders and the Workforce

1 The culture of the company should align with its strategy and values and the board should be mindful of their role in leading by example and promoting the company's culture. The annual report should describe the company's business model and how its governance helps to deliver its strategy. Culture is a common theme and any action taken to correct practices which conflict with the company's culture must be described in the annual report.

2 Investment in the company's workforce is crucial to the long-term success of the company. Workforce policies and practices should reflect the company's values and there should be a means for the workforce to raise any matters of concern (in confidence and anonymously). The Code provides three methods to demonstrate engagement with the workforce (i) a director should be appointed from the workforce, (ii) the Company should establish a formal workforce advisory panel, or (ii) a designated non-executive director should be appointed to engage with the workforce. If one or more of these methods is not employed, the Company should explain in its annual report what alternative arrangements are in place and why those arrangements are considered to be effective.

3 Shareholder engagement is a key theme of good corporate governance. The Code recommends that committee chairs seek engagement with shareholders on significant matters related to their areas of responsibility. This should be reported back to the board to ensure that the full board are aware of shareholder views. Participation from shareholders in these discussions should be actively encouraged. Crucially, when 20 per cent. or more of votes have been cast against a board recommended resolution, the company should (i) explain what steps it intends to take to understand the reason for shareholders voting against the board's recommendation, (ii) provide an update to the market on progress and shareholder views within six months of the date of the relevant meeting, and (iii) include a final summary in the annual report on what decisions have been taken as a result of the consultation with shareholders.

4 To demonstrate that shareholders' views are being taken on by the board and are considered in their decision-making, the annual report must include an explanation of how the board have had regard to the matters set out in section 172 of the Companies Act 2006 (a statutory duty of directors to promote the success of the company). This applies regardless of whether the company is a UK company or not.

The Board and its Committees

5 A majority of the board, excluding the chair, should be independent non-executive directors. There is no dispensation for smaller, non-FTSE 350 companies.

6 All directors are now subject to annual re-election at the company's annual general meeting. There is no dispensation for smaller, non-FTSE 350 companies. In practice, many companies already follow this rule, however, the annual report should describe the specific reasons why each director's contribution is, and continues to be, important to the company's long-term sustainable success.

7 There is a maximum length of service for the chair of the company of nine years, commencing from the date of the chair's first appointment to *the board*. This period can be extended "*for a limited period of time*" to assist with succession planning.

8 FTSE-350+ companies must have a minimum of 3 audit committee members and 3 remuneration committee members (smaller companies must have at least 2 in each case). All committee members should be independent non-executive directors.

9 The chair of the remuneration committee must have served on the remuneration committee as a member for at least 12 months before his/her appointment as chair.

10 The remuneration committee has an enhanced role and is responsible for overseeing remuneration and policies in respect of the board, senior management and the workforce.

11 Share options with a longer term are recommended for executive directors and the minimum vesting period has been extended from three years to five years or more. This is to align executive interests with long-term shareholder interests. Performance-related pay should not be guaranteed on the basis of formulaic calculations and discretion should be applied when making awards and poor performance should not be compensated in any circumstance.

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