Bird & Bird & Capital Markets Group: PLC Update

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FRC Consultation on changes to The UK Corporate Governance Code

On 28 February 2018, the Financial Reporting Council's ("FRC") consultation on its proposed changes to the UK Corporate Governance Code (the "Code") closed. The FRC intends to publish the final version of the proposed Code in early summer 2018, with a view to it coming into force for accounting periods beginning on or after 1 January 2019.

The FRC has publicly stated its desire to make the Code more concise, while ensuring that it remains suitable to meet the needs of the modern UK economy. The version of the Code proposed by the FRC includes substantial amendments both to the substance and form of the current UK Corporate Governance Code. The Code is to be made up of 17 Principles, supplemented by Provisions, which give additional detail to each Principle. The end result is likely to result in a much shortened version of the Code.

As noted in our article on recent changes to the AIM Rules, which can be found here, certain changes have been made to the AIM Rules in order to require AIM-listed companies to comply with a 'recognised' corporate governance code or, alternatively, explain the reasons for any non-compliance. One of those recognised governance codes is the UK Corporate Governance Code and, accordingly, AIM companies will need to take note of the final changes, once they are brought into effect if they currently or intend in the future to follow the Code.

The proposed Code will be organised under the following five sections (with most of the changes of substance included in the first three sections):

1 Leadership and Purpose

2 Division of Responsibilities

3 Composition, Succession and Evaluation

4 Audit, Risk and Internal Control

5 Remuneration

The proposed Code is intended to continue to address the issues of corporate governance that contribute to board effectiveness, while encouraging focus on important issues such as workforce engagement, diversity and corporate culture.

Some of the key changes which are proposed include:

Focus on the Workforce

The FRC has made a concerted effort to use the term 'workforce' through the proposed Code, moving away from previously used terms, such as 'employee'. The proposed Code is intended to make companies consider the implications of their actions on a wider group of workers, including those who do not have formal employment contracts, such as agency workers and contractors.

The proposed Code also requires the board to gather the views of the workforce. This will normally be achieved by having a designated non-executive director, appointing a formal workforce advisory panel or having a director appointed from the workforce.

The proposals also require companies to enable whistleblowing - companies should establish a means for the workforce to raise concerns in confidence and (if they wish) anonymously. Boards should ensure that arrangements are in place for independent investigation and for follow-up action.

Shareholder engagement

The proposed Code provides that the chair should seek regular engagement with major shareholders to understand their views on governance and performance against strategy. There is a separate requirement for chairs of committees to engage with shareholders on significant matters related to their areas of responsibility.

Resolutions with 20% opposition

The proposed Code aims to enhance transparency for shareholder resolutions for which there is significant shareholder opposition. The FRC wants companies to understand why such a large portion of votes were cast in opposition to such resolutions.

Where more than 20% of the votes are cast in opposition to a resolution, proposed new provisions in the Code would require that the company explains, at the time of announcing the result, the actions it intends to take to consult with shareholders in order to understand the reasons behind the result. An update should be provided no later than six months after the vote and a final summary included in the annual report (or in notes to resolutions at the next meeting) on the impact of the feedback on decisions of the board and on actions or resolutions now proposed.

The Investment Association has separately established a public register of companies in the FTSE All-Share who have received significant shareholder opposition to proposed resolutions or have withdrawn a resolution prior to the shareholder vote.

Independent Directors

The existing Code set out various circumstances relating to a director that might affect his or her independence (such as representing a significant shareholder) and requires the board to state its reasons for determining that a director is independent, if any of these circumstances exist. Under the proposed Code, where any of these circumstances exist, directors should not be considered to be independent.

Under the proposed Code, independent non-executive directors, including the chair, should constitute the majority of the board (unlike the existing Code, no differentiation is made for smaller (non-FTSE 350) companies). All directors are also to be re-elected on an annual basis (again no distinction is made for smaller companies).

There should also be a minimum of three independent non-executive directors on the remuneration and audit committees (no distinction is made for smaller companies).

Diversity

According to the proposed Code, both board appointments and succession plans for board and senior management should promote diversity of gender, as well as, social and ethnic backgrounds. Diversity of the board should be part of the regular evaluation of the board and the annual report should include an explanation of how diversity supports the company in meeting its strategic objectives.

The draft guidance to the proposed Code anticipates that the nomination committee will need to play an active role in setting and meeting diversity objectives and strategies and that this should be described in the annual report.

Remuneration procedures

The proposed Code includes a new requirement for companies to explain how executive remuneration falls into line with wider company pay policy.

The remuneration committee will also have an increased role – its ambit will be extended to senior management and it is expected to oversee remuneration and workforce policies generally.

Director and senior management performance-related remuneration should be "*clear, stretching, rigorously applied and aligned to the successful delivery of the strategy*". The board should have discretion to override formulaic outcomes and the ability to recover or withhold sums or share awards in specified circumstances.

The remuneration committee chair should have served on a remuneration committee for at least 12 months.

For more information please contact:

Clive Hopewell
Partner

Tel: +442079056370
clive.hopewell@twobirds.com