



**CLEVELAND & CO**

External in-house counsel

FRC PROPOSES  
REVISED UK  
CORPORATE  
GOVERNANCE CODE

3 April 2018

On the 5 December 2017, the Financial Reporting Council (“**FRC**”) published a consultation document on its proposals for a ‘shorter and sharper’ revised UK Corporate Governance Code (the “**Revised Code**”). The UK Corporate Governance Code (the “**Current Code**”) sets out the standards of good practice for companies in relation to:

- board leadership and effectiveness;
- remuneration;
- accountability; and
- relations with shareholders.

The Revised Code builds on the FRC’s findings from its 2016 report on corporate culture and the role of boards (the “**Culture Report**”) which found that fostering the right culture within a business is key to long-term sustainable performance. The key areas contributing to a firm’s long-term success now relies on:

- transparency;
- stakeholders;
- board effectiveness;
- corporate purpose;
- diversity; and
- overall effective governance.

The Code applies to all companies with a premium listing of equity shares in the UK and who are required under the Listing Rules<sup>1</sup> to publish in their annual report how they have applied the Current Code in a way that would enable shareholders to evaluate how the principles of the Current Code have been applied. Nonetheless, as compliance with the Code is considered best practice, many unlisted but publicly traded companies, such as AIM companies, still apply the Code in some shape or form.

The Revised Code seeks to maintain the key strengths of the Current Code such as an emphasis on shareholder rights and retaining the flexibility of the principle ‘comply or explain’ in a way that allows each company’s specific circumstances to be taken into account. In terms of its structure, the FRC proposes that the Revised Code be divided into 5 broad sections:

- 1) leadership and purpose;
- 2) division of responsibilities;
- 3) composition, succession and evaluation;
- 4) audit, risk and internal control; and
- 5) remuneration.

## LEADERSHIP AND PURPOSE

### Culture and stakeholders

In line with the FRC’s Culture Report, a board should establish the company’s purpose, strategy and values and ensure these are evident both: throughout the entire organisation and in how it conducts business and engages with stakeholders.

---

<sup>1</sup> LR 9.8.6(5)

For example, when more than 20% of votes against a resolution have been cast, the company should explain what actions it intends to take to consult with shareholders in order that they understand the reasons behind the vote. Furthermore, in response to the Government's Green Paper, and in line with these proposed revisions to the Code, the Investment Association, has set up and will oversee the world's first public register of listed companies detailing companies who have received significant shareholder opposition to proposed resolutions or have withdrawn prior to the shareholder vote.

### **Wider views of stakeholders**

The board should establish a method for gathering employee views (including those categorised as workers or contractors) and there should be a means for employees to raise concerns in confidence and anonymously. There are three ways a company can implement this, either:

1. through a director appointed from the workforce;
2. a formal workforce advisory panel; or
3. a designated non-executive director.

This reflects a change from the Current Code which only provides for an audit committee to review methods by which staff may raise concerns.

## **DIVISION OF RESPONSIBILITIES**

### **Clarifying the role of the Chief Executive**

The role of the chief executive has been clarified and now includes proposing and delivering strategy and ensuring the board receives this in a timely and balanced way.

### **Board composition**

This remains broadly the same however, the chair is now considered to be independent at all times. This means that non-executive directors, including the chair, should constitute the majority of the board, previous wording had excluded the chairman. In addition, the proposals remove the exemption for companies below the FTSE 350. This is because the FRC believe that as the Code sets good practice, smaller companies should aim for the same high standards of corporate governance. However, the FRC appreciates the impact of this could be both costly and burdensome, and therefore welcome views on the effect of this proposal.

### **Independence of non-executive directors**

The Revised Code strengthens the provisions on independence, focusing on non-executive director and chair independence, as the former has been consistently rated as the lowest in terms of compliance. The emphasis has now been changed where a non-executive director and/or chair does not meet the stated criteria, they "*should not be*" considered independent where the Current Code simply requires that the board identifies who is considered to be independent. This may prove to be controversial, however it is noted that companies still have the option of offering an explanation, in line with the 'comply or explain' principle if they believe the individual is still independent.

## **COMPOSITION, SUCCESSION AND EVALUATION**

### **Appointments to the board**

Following a number of reviews, diversity has been encouraged, not only to promote gender equality but also appointments from different social and ethnic backgrounds as well.<sup>2</sup> The Revised Code requires appointments to the board to be subject to formal, rigorous and transparent procedures and that an effective succession plan should be in place for board and senior management. Both plans should be based on merit and objective criteria. Building on this, the remit of the nomination committee has been expanded to oversee the development of a diverse pipeline for succession. The annual report should describe the work of the nomination committee and include information such as detailed descriptions of how evaluation has been conducted and the gender balance of those in senior management. These proposals align with the Government's long term plans to enhance the UK's position as a centre of asset management.<sup>3</sup> The FRC is proposing that all companies should increase transparency in this area, not only FTSE 350 companies.

## REMUNERATION

### General remuneration

A requirement that the remuneration committee chair should have served on a remuneration committee for at least 12 months has now been included. The FRC has sought to address rising concerns over levels of executive pay and the need to improve the experience of the workforce and long-term success of the company. Following general market practice, changes have also been implemented to extend the minimum vesting and holding period for executive share awards from three to five years.

### Role of the board

The role of the board has been emphasised in exercising independent judgement and discretion when approving remuneration outcomes, taking into account company and individual performance. A board is now able to override any formulaic outcomes, for example where the measurement of performance condition does not reflect the actual performance of the individual director.

## NEXT STEPS

Company boards should also consider the impact of other FRC Guidance such as the Guidance on Audit Committees and Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. The FRC aims to publish a final version of the Revised Code by early Summer 2018. The Revised Code will apply to accounting periods beginning on or after 1 January 2019.

To access the Investment Association's public register detailing companies who have failed to secure significant support for their annual Remuneration Reports, please click [here](#).

To access the proposed revisions to the UK Corporate Governance Code, please click [here](#).

---

<sup>2</sup> Hampton-Alexander Review: FTSE women leaders: Improving gender balance in FTSE leadership, November 2017; Sir John Parker, The Parker Review Committee: A report into the ethnic diversity of UK boards, October 2017; Lord Davies, Women on Boards, February 2011

<sup>3</sup> Further information on the governments long term plans for the investment management industry outlined in their Investment Management Strategy Report II can be found in our previous article entitled "HM Treasury unveils long term plans to support asset management industry."

To access the consultation questions on changes to the UK Corporate Governance Code, please click [here](#).

For more information or advice on the Revised Code, Cleveland & Co external in-house counsel, your specialist outsourced legal team, are here to help.

## DISCLAIMER

No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any constituent part of Cleveland & Co Associates Limited accepts or assumes responsibility, or has any liability, to any person in respect of this document. Copyright in the materials is owned by Cleveland & Co Associates Limited and the materials should not be copied or disclosed to any other person without the express authorisation of Cleveland & Co Associates Limited. This document is not intended to give legal advice and, accordingly, it should not be relied upon. It should not be regarded as a comprehensive statement of the law and practice in this area. Readers must take specific legal advice on any particular matter which concerns them. If you require any advice or information, please speak to your usual contact at Cleveland & Co Associates Limited.

## WHY WE'RE DIFFERENT

Cleveland & Co are specialists in financial services, investment management and commercial contracts and related courses. Our team's in-house experience means we understand client challenges and we work alongside you to create solutions. We can provide insight on real vs hypothetical risks and help your team evolve.

## WE OFFER

Cleveland & Co offer you fixed fees and retainer structures that provide you with certainty of cost and we offer industry experience that cuts through common legal complexity.

## CONTACT

EMMA CLEVELAND

Managing Director

+44.79.6387.8756

ecleveland@cleveland-co.com

www.cleveland-co.com



Cleveland & Co Associates Limited is incorporated in England and Wales, company No. 07871988 Unit B404, The Biscuit Factory, Drummond Road, London, SE16 4DG, VAT number 144 6988 70. Cleveland & Co Associates Limited is authorised and regulated by the Solicitors Regulation Authority (SRA) under no. 622069, as an alternative business structure, and as such all our solicitors are subject to the principles and code of conduct set out by the SRA. Please visit <http://www.sra.org.uk/handbook/> for more information.