RATHBONES

11th September 2023

Financial Reporting Council
8th Floor
125 London Wall
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To whom it may concern,

RE: CORPORATE GOVERNANCE CODE CONSULTATION

Rathbones believes it is in the best interests of our clients for the companies in which we invest to adopt best practice in corporate governance and ESG risk management. This is because best practice in ESG provides a framework in which each company can be managed in the long-term interest of its shareholders. As such we are fully supportive of the provisions of the UK Corporate Governance Code (the Code), and we are signatories to the UK Stewardship Code. As such, we welcome this opportunity to engage with the FRC on the proposed revisions to the Code as set out in the consultation document.

Section 1: Board leadership and company purpose

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

We welcome the changes to Principal D. We agree with the FRC that investors need better, not more, information which is decision useful. The focus on outcomes brings alignment with the expectations of the UK Stewardship Code which is helpful. We are pleased to see continued support for 'comply or explain' in this revised wording.

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?

This one is more open for debate. We have already established mandatory reporting structures such as TCFD, in which case we want to avoid creating duplication of reporting effort. Climate risk is clearly an issue of great importance to companies, but the Code will do well to encourage engagement with a range of ESG / traditionally non-financial risks. The revised wording makes it clear that climate ambitions and transition planning are to be considered along with environmental and social matters as a matter of focus, but not exclusive to the detriment of work on other ESG risks, which is welcome. A stronger link with directors' duties under section 172 would be welcome.

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

We are supportive of the proposed change for committee chairs to actively engage with shareholders and for improved disclosure in the annual report regarding the outcomes of such engagements. It would be useful for companies to disclose the number of shareholders included in such engagements given that smaller shareholders are often missed out in consultation exercises.

Section 2 – Division of responsibilities

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?

We welcome changes in this area. Our bespoke voting policy takes a firm view on the number of additional roles a board member can take. It is vital that directors have enough capacity not just for business and usual responsibilities and activities but to respond in times of crisis.

We agree that prescribing a specific number of directorships is not appropriate. However, some indication and guidance may be helpful – perhaps suggesting a restriction of the number roles at FTSE100 companies, serving as SID or Chair at no more than one FTSE 100 company or which have a large turnover.

We are dubious about the efficacy of making external commitments part of annual performance reviews. In our experience, we have not encountered a company that has agreed with us when we have pointed out concerns over incidents of 'overboarding' – companies would simply report that they had assessed their responsibilities and found them to have capacity. The best indicator of an unmanaged risk in this area remains the overall number of board level commitments.

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?

The provision change is welcome, but could go further to include significant appointments beyond the corporate world, such as being a chair of trustees of a major charitable foundation, or being a visiting academic etc. As reported above, the role of Senior Independent Director should be treated the same as chair in terms of only being able to be fulfilled at one FTSE 100 company by a single person.

We feel more clarity can also be provided on positions at investment companies given these often pose as less onerous time commitments but can often represent the majority of directors' external responsibilities.

Section 3 – Composition, succession and evaluation

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

We agree with the aim of creating a more joined up approach, and consider the changes suitable to this end.

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?

We are supportive of this move.

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

The goal of encouraging boards to report their individual achievements and actions rather than making boilerplate statements is welcomed. It is welcome to have diversity considerations specifically mentioned in the succession planning process, and the debate is mature enough among UK PLC to ask boards to assess the 'effectiveness of diversity and inclusion policy'.

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?

We welcome the change of 'consider' to 'commission in new principle 22. However, we have little confidence that board evaluations are conducted with genuine rigour. Investors have the ultimate sanction on the effectiveness of a given director.

Section 4 – Audit, risk and internal control

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

We agree with this step. As investors' capacity to analyse and react to corporate disclosure on governance issues matures, this additional disclosure will find active use in the investment community. We support the decision by the FRC to give this responsibility to the Audit Committee – this feels the logical place. We also agree that producing an AAP would be of benefit to a wide range of companies.

The encouragement for Audit Committees to engage more with investors is also welcome, especially as their remit to cover ESG disclosures enlarges, however improved disclosure should be provided on how the Audit Committee has assessed the independence of the external auditor.

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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?

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?

Having reliable and comparable sustainability and ESG data is of great importance to investors. Given the current landscape, it seems logical to expand the remit of the audit committee to cover this area, given 'wide ranging differences in how companies report on and seek assurance, in relation to their sustainability-related disclosures.' We agree that 'The audit committee has experience in setting policies and frameworks which could be adapted to ESG metrics, and as such it is best positioned to oversee ESG disclosures, controls, processes, and assurance.'

We therefore support the addition to principle 26 of the following wording:
'monitoring the integrity of narrative reporting, **including sustainability matters**, and reviewing any significant reporting judgements;'

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?

We do not feel the requirements are overly onerous. We agree that 'Increased transparency on how effectively the board manages risks to the company's objectives, including operational, reporting and compliance objectives, increases investor and stakeholder confidence'.

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?

If this statement refers to the Board's declaration on risk management and internal controls, we consider that the declaration should be ongoing and so should relate up until the date of the annual report. If something changes between the balance sheet date and date of the annual report investors would benefit from that knowledge.

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?

Broadly agree that the internal risk architecture should think more deeply than pure financials, in line with directors' duties and investors' best interests.

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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)?

We agree with this assertion, as consistency across all companies is a valuable aim.

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

We agree with this assertion.

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?

The wording is sufficiently broad in our view. Again, the aim is not prescriptive tick-box compliance, so the first sentence about the context of current position and principal risks suggests a proportionality.

Section 5 - Remuneration

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

It is our view that formal linkages between ESG metrics and pay should be considered carefully. We have seen examples of companies using ESG provisions in pay arrangements to set a very easy 'floor' for attainment, meaning that ESG metrics were easily obtained in times of others challenging financial performance. Any linking of ESG metrics should be done with a clear link to company strategy and future prospects. The time horizon should considered – progress on reducing climate impacts for example is a medium to long term goal, and should be reflected only in as much as it has contributed to medium term and long-term performance. We therefore support the new wording of principle 'P' which links remuneration outcomes to 'successful delivery of the company's long-term strategy including environmental, social and governance objectives'.

We welcome the specific guidance that no director should be involved in setting their own remuneration outcomes.

However, many of these expectations were in the previous Code in some form. Executive pay levels continue to diverge greatly from average incomes, with sub-optimal outcomes for investors. We would like to see wording to the effect that pay should align with shareholder as well as wider stakeholder experience. There should also be more clarity in the Code between standards of base pay and variable pay outcomes. Most of the debate in the real world comes down to this division. Rathbones often engages with companies where we see base pay as sufficient for incentivising all manner of positive

behaviours – in short not every outcome should be incentivised by variable pay . The Code should make clear that more transparency is needed on what 'additionality' is being delivered by variable pay arrangements above and beyond the core competencies expected of all senior staff, rewarded by their annual salary.

Remuneration committees should be encouraged to disclose why they haven't considered phased increases to large base salary increases that greatly exceed those provided to the wider workforce. This allows for time in the role for a new executive director and provides a steady increase for the overall quantum of pay, given that variable pay is paid as a % of base salary. All too often, remuneration committees increase base salaries in lump sums rather than phasing over a two-to-three year period.

We are supportive of a more holistic approach to setting executive pay that takes into consideration the experiences of wider stakeholders, particularly employees. The alignment of executive director base salary increases with those received by the wider workforce is a red herring as ultimately the final value taken home is completely different. We find the information around average bonuses or other forms of variable pay paid to the general workforce is lacking.

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

When engaging with companies, our biggest point of debate on malus and clawback is over their intended use. Many companies simply report their existence – we would welcome more reporting on how a remuneration committee plan to use them and in what circumstances. We hope these new provisions will encourage a deeper thought around this area and hence better reporting.

We would also welcome transparency on which triggering events have been considered most important and why. In relation to the discussion above, boards should consider malus and clawback in cases of material ESG failures as well as financial and operational issues.

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

Broadly yes. We would suggest adding whether remuneration committees have considered using malus and clawback. We agree with the proposal for companies to set out the historical five-year context of the use of malus and clawbacks provisions. We would also like to see the reasons provided as well as the figures.

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

We find that benchmarking is the most over used rationale for salary increases. We have yet to see a company conclude, after scanning the market for gaps and comparing external pay rations, that pay should decrease or stay static. We would welcome the wording being retained, with some suggestion once again that the core driver be alignment with strategy and shared success.

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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?

No views to express.

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