WONDERFUL ON TAP

SEVERN TRENT

Severn Trent Centre
2 St Johns Street
Coventry
CV1 2LZ

Financial Reporting Council
Code Review Team
By email: codereview@frc.org.uk

12 September 2023

Dear Sirs

Response to Financial Reporting Council paper 'Corporate Governance Code Consultation'

We write with respect to the Financial Reporting Council's (FRC) 'Corporate Governance Code Consultation'. We welcome the opportunity to contribute our views on the proposals, and support the FRC's objective to enhance the Code's effectiveness in promoting good corporate governance.

We have contributed to the response submitted by GC100 to the consultation and endorse the points outlined in that response. In addition to the GC100 response, this letter sets out a summary of the key themes we feel are most crucial and warrant further consideration, and response, by the FRC.

Impact on the UK's ability to attract and retain capital

The UK's strong reputation is crucial to its ability to continue to attract and retain capital. We would consider that the following principles should inform the FRC's work in ensuring that the UK maintains an effective, proportionate and practical regulatory framework:

> Proportionality and costs: Proportionality is a key principle in the regulation of companies. As such, it is essential that the principle of proportionality is applied to all matters concerning company regulation, and the proposed reforms to the Code, particularly in light of the expected significant increase in costs for businesses.
>
> The cumulative impact of new obligations on companies and their directors is likely to create additional costs as companies internal and external audit resource requirements, to enable directors to evidence they are meeting the new obligations, are likely to increase. The proposed changes outlined within the Revised Code are additive in nature,

with many changes which are not connected to the Government's broader Restoring Trust in Audit and Corporate Governance reforms.

Over-regulation: Imposing additional obligations over subject matter which is already covered by other regulation leads to over regulation and uncertainty / confusion among those companies and individual directors subject to regulation. Crucially, regulation must not be duplicative with other requirements. Current drafting identifies several instances of duplication in the Revised Code, most notably duplication with the FCA's Listing Rules.

UK as an investment destination of choice: Increasing the compliance burden (and cost) for companies may affect the UK's competitiveness as a preferred destination for corporate and capital market activity. Implementing significant new rules on companies and directors through the Revised Code has potential to counter the Government's ambition, and the work which the FCA is currently undertaking, to make London a more attractive listing venue. A number of high profile companies are opting to list their shares in what are perceived to be more attractive capital markets, thereby questioning the UK's attractiveness as a listing destination. This is before the proposed reforms are implemented.

Impact on boards

The success of companies is dependent on high quality and diverse boards. It is crucial that companies maintain their ability to attract and retain talented and experienced directors. The principles outlined below seek to inform the FRC's work in ensuring that UK companies can maintain effective board oversight and challenge:

Attractiveness of serving as a listed company director: The cumulative impact of new obligations on directors of UK listed companies, as outlined in the Revised Code, should be considered. Although not an issue for our business, boards more broadly are finding it increasingly challenging to attract the talent, quality and diversity of background and experience desired to enable effective decision-making and board oversight. This is contrary to what the Government wish to see. There are many practical instances of quality candidates deciding against joining a listed company board, particularly where they are being recruited to join the audit and risk committees, over concerns relating to over-regulation and incurring potentially unlimited personal liability.

In addition to audit and risk committees, the impact on broader board committees is also significant. With the increasing responsibilities placed on them, as set out in the Revised Code, non-executive directors will be required to do even more and to commit more time than their traditional supervisory role suggests, which could have an unintended adverse impact on the effectiveness of boards and the companies they serve.

Additional directorships: Principle K requires consideration of all commitments to other organisations, and not just significant external commitments or significant director appointments. There should be consistency of which commitments / appointments are covered by Principle K and Provision 15, making clear in particular whether the scope is: (a) only significant roles; (b) directorships only; and/or (c) other public roles. It is important that companies have discretion to determine what is in fact "significant", as this is very much dependent on the company and the individual circumstances of the relevant director in the context of their other commitments.

An unintended consequence of the proposals could result in non-executive directors being forced to reduce the number of directorships (and other appointments) they hold, thus depriving companies (particularly charities or other not-for-profit organisations) of crucial skills and experience. The increased exposure could also have a negative effect on high quality / experienced candidates for non-executive positions thereby reducing the pool of talent and making it more likely that companies would be forced to engage less experienced candidates.

Succession planning: Succession plans, particularly for senior management, are confidential and often commercially sensitive – as they relate to individuals and their potential career progression. Accordingly, any disclosure around succession planning must be high level, talking about the process rather than the outcomes or, named individuals. This will inevitably result in boilerplate reporting that does not provide any value to shareholders and broader stakeholders (similar in fashion to the current requirement to report against Provision 40). Feedback from our investors confirms that they want to understand that there is a process in place but are not interested in the level of detail which the revised Provision 40 includes.

In addition there is duplication between the amended Provision 24 and the existing Listing Rule requirements.

Risk management and internal controls

In its response on strengthening the UK's audit, corporate reporting and corporate governance systems published in May 2022, the Government outlined potential risks presented by requiring a director's statement on risk management internal control systems on a legislative footing. The changes proposed in the consultation seek to implement the Government's policy decision by making clearer the board's accountability for risk management and internal controls and enhancing transparency by providing a stronger basis for reporting on and evidencing the effectiveness of the framework of risk management and internal controls.

Acknowledging that the Code is principles-based, it is challenging to assess the detailed implications of the proposed changes without further guidance. In the absence of detailed guidance and worked examples there is potential for a wide range of interpretation which could lead to boilerplate disclosures which would not be comparable across organisations nor meaningful for companies' shareholders and broader stakeholders. We hope that the FRC will take the time to consult widely on the supporting guidance and we would welcome the opportunity to provide feedback as part of that process.

Additionally, revisions to the Code have expanded to cover all reporting controls. The landscape for non-financial reporting, particularly in relation to ESG, is evolving and assurance for such reporting is not well developed. In these circumstances, it is not clear that consistent rigorous standards for reporting or controls can be defined in the way that they may be for financial reporting. We therefore consider that an approach that limited reporting to controls over financial reporting in the first phase would be preferable with extension to all reporting controls when frameworks for non-financial reporting are better established.

A phased approach to implementation or allowing companies to declare components of risk management and internal control systems will also lead to better outcomes through extending the timeframe to embed controls over new reporting requirements before assessing and disclosing their effectiveness.

In response to the Board's declaration on reporting date, we note that the annual report covers the financial year of the company. It is important for users of the Annual Report and Accounts to understand whether internal controls have operated effectively throughout the period being reported upon. It would be impractical to provide the same level of assurance up to the date of the annual report but it would be reasonable to expect that any material control deficiencies identified between the balance sheet date and the date of the annual report would be disclosed in the event required.

Narrative reporting and non-financial metrics

We support the integration of environmental and social matters with the broader strategy and are supportive of changes to Provision 1 requiring that boards describe how environmental and social matters have been taken into account in the delivery of overall company strategy.

We believe that there should be a governance structure for sustainability reporting, but do not believe that this will necessarily sit within the remit of the audit committee.

The FRC acknowledges that organisations are building experience in different ways and the issues related to sustainability and ESG might be dealt with by risk committees, management teams or external experts. For example, Severn Trent already has an established board corporate sustainability committee, and therefore robust governance over sustainability matters are already in place and adequately reported.

We hope that further contemplation and discussions around these themes will result in mutually beneficial solutions for the FRC, those it regulates, and the UK economy as a whole. Should the FRC team wish to discuss any of the points raised in further detail, I would be delighted to meet with them.

Yours faithfully,

[redacted]