ABI

Director of Corporate Governance and Stewardship
Financial Reporting Council
8th Floor
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13 September 2023

Dear Mr. Styles

UK Corporate Governance Code Consultation

We are grateful for the opportunity to respond to the Financial Reporting Council's (FRC) consultation on the revisions to the UK Corporate Governance Code and welcome its review. While we are supportive of the continuous improvement of the Code, specifically those revisions in response to the Department for Business and Trade's (DBT) white paper on restoring trust in audit and corporate governance, we do have several key concerns. We highlight these in our response to the detailed consultation questions and in this cover letter.

Proportionality

Generally, there is concern that the requirements as currently written will be **disproportionate and** may lead to **unintended consequences**. For instance, if the additional requirements of the revised Code are not proportionate, companies may elect to explain their non-compliance rather than complying, undermining the FRC's desired outcomes. Whilst we acknowledge and welcome the flexibility given to firms to apply the Code on a "comply or explain" basis, requiring firms to provide a detailed explanation of non-compliance appears more rules based than principles based. This again could undermine the aims of the Code. A **disproportionate compliance burden** created by the additional requirements in the Code would **discourage investment in the UK and risk damaging the UK's competitiveness**. We are supportive of DBT's Smarter Regulation review which aims to deliver an "*improved better regulation framework*" and "*reform regulations to reduce burdens*". Any revisions to the Code should consider the aims of the Smarter Regulation review. The current proposals would also likely result in greater responsibilities placed on directors and may make Board roles in relevant firms less attractive, inadvertently leading to a smaller pool of willing directors.

Risk Management and Internal Control Requirements

Several concerns raised by our members relate to the revisions to Section 4 of the Code, specifically around risk management and internal controls. A strong view had built that the proposed revisions to the principles and provisions on internal controls would be a UK equivalent of the Sarbanes-Oxley Act (UK SOx). This stemmed from a lack of clarification from the FRC that it was not the intention for the proposed revisions to bring in a UK SOx regime. Even though the FRC informally confirmed in its webinar "*What we've heard so far*" on 25 July that this is not the intention, we urge the FRC to make this clear through the publication of its additional guidance. **Guidance providing the required clarity over the various proposals in Section 4 will be critical for firms** as it will not only allow for proper impact assessments to be performed but also allow firms to apply the code in a meaningful way. We are supportive of the need for clear guidance and urge the FRC to further consult with companies on this intended guidance.

The concerns around the revisions to the principles and provisions over internal controls which have been

expressed by our members relate to the **broadness of scope** of the proposed internal controls over which the Board is required to monitor and review. This includes concerns around the proposals to **extend the scope to "reporting"** rather than purely "financial" controls. Additionally, firms feel that **including "operational" and "compliance" controls is not a proportionate means of strengthening risk management and internal controls systems**. Currently, there is no distinction between operational, compliance and reporting controls in terms of the frameworks or structures that would be considered appropriate to support new Board declarations. Given the lack of distinction, there is a risk that organisations are more likely to develop frameworks that are less proportionate and less flexible than intended by the FRC. Further concerns around the inclusion of operational and compliance controls within scope is that this will **significantly affect the cost of complying with new requirements**, even after taking into account the FRC's suggested focus on only the most material or significant controls. This will risk damaging competitiveness particularly for smaller businesses within a larger regulated group. The cost-benefit analysis of the proposed revisions needs to be carefully considered. We provide greater detail on these concerns in our response.

Implementation

It is also important to note that concerns have been expressed over the **implementation timelines** for firms. Firms feel that these may be too short especially given the proposed revisions around the controls framework. Further guidance which is expected in December 2023 (at the earliest) is likely to be too late for a 1 January 2025 implementation. The insurance industry in particular is coming off the back of the implementation of IFRS 17, with further regulatory change impacting operations in other areas such as the new Consumer Duty requirements and the Solvency II regulatory regime reforms. More widely, businesses are preparing for new sustainability reporting standards. **Further significant regulatory changes would put additional strain on the industry**.

High Quality Disclosures from a Principles Based Regime

We remain supportive of the fact that the Code **remains principles based and emphasises the need for high quality and insightful disclosures.** There is a need to avoid gold-plated disclosures that bring no material added value and that may overlap with and duplicate existing regulatory disclosure requirements elsewhere. We also agree with the FRC that boilerplate statements, playing back the words within the Code rather than applying the spirit of the Code, do not deliver the transparency that the market needs. We support revisions to the Code which aim to remove any provisions which lead to boilerplate disclosures. We encourage the FRC to ensure that any new requirements introduced will not lead to or encourage boilerplate disclosures to be made. We point out these concerns in our detailed response.

Regarding sustainability reporting including ESG metrics and sustainability strategies (including the transition plans to reach Net Zero), while we are strongly supportive of more public reporting in this area, we **do not want to see companies deterred from making ambitious statements by overly prescriptive rules.** Currently, the availability of data and evidence is gradually improving, which in turn is driving an increase in the sophistication of sustainability reporting, across the whole economy. However, this is not at an equivalent level of maturity to other more well-established aspects of financial reporting. Some aspects have improved significantly in recent years but even so the evidence base is far from complete. Other equally important aspects of sustainability are at a very early stage of development. As such, some of the proposals in this consultation (such as expanding the remit of Audit Committees to sustainability and the proposed scope of the remit over internal controls), **may be interpreted as preventing the disclosure of much of this information by businesses – as strategies will currently be informed by qualitative evidence, proxy datasets and advice from third parties** (rather than well-established quantitative datasets).

Limiting disclosures for this reason would, however, prevent other businesses who wish to learn about a company's sustainability strategy from making informed decisions. This would be unwelcome. The publication of

ambitious strategies, targets and transition plans – even where the underlying data is less mature – allows other businesses to identify opportunities to collaborate and innovate. This also allows businesses to make informed choices about how their investment, underwriting and procurement decisions can be utilised most effectively. Instead of prescriptive rules in these areas, the **code should explicitly recognise the relative immaturity of the evidence base on sustainability**. It should then promote the publication of ambitious, transparent disclosures on sustainability strategies and actions to improve the maturity of the underlying data and evidence base over time. As ABI members will be both preparers and users of these disclosures, we want to see an environment that **encourages firms to adopt ambitious sustainability strategies**, which includes being comfortable in disclosing where there is uncertainty or risk to delivering the strategy. It is vital therefore that **firms are given the flexibility to produce iterative disclosures** (which may change year-on-year as new evidence emerges), evolve their sustainability strategies over time and provide relevant information to the market in an accessible format.

In conclusion, we acknowledge the large amount of work that the FRC has undertaken to date as part of this consultation. However, we are mindful of the key concerns raised by our members and the potentially significant impacts the revised proposals may have on their businesses. It is therefore in all of our interests for this review to be robust and to result in a meaningful outcome that does not disproportionately impact our members ability to apply the Code. We undertake to continue to closely engage and collaborate with the FRC to ensure the review of the Code results in balanced, proportionate and practical principles and provisions. The FRC should carefully consider the feedback it receives and must do what is necessary to demonstrate to firms that their voices in this regard are being heard. We would welcome the opportunity to discuss the content of our response in detail if required and look forward to ongoing close collaboration with the FRC on this and other future topics.

Yours sincerely,

The ABI.

ABI

UK Corporate Governance Code

ABI Response to the Consultation

The UK insurance and long-term savings market and the ABI

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry. A productive and inclusive sector, our industry supports towns and cities across Britain in building back a balanced and innovative economy, employing over 300,000 individuals in high-skilled, lifelong careers, two-thirds of which are outside of London.

The UK insurance and long-term savings industry manages investments of over £1.9 trillion, contributes over £16bn in taxes to the Government and supports communities across the UK by enabling trade, risk-taking, investment and innovation. We are also a global success story, the largest in Europe and the fourth largest in the world.

The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK. Please note we would be happy, and stand ready, to provide further information if this would be helpful to HM Treasury.

For the purposes of this response, 'insurers' refers to insurance, reinsurance and long-term savings companies.

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

1. We acknowledge the FRC's rationale for introducing the new principle on outcomes-based reporting. However, we would emphasise that outcomes may take time to materialize within a company. There is a risk that in trying to comply with the Code, companies may feel pressure to produce outcomes for reporting purposes. This may lead to boiler-plate statements which would go against the aims of this new principle. An example of this would be some section 172 reporting.
2. We suggest that the FRC introduce guidance on outcomes-based reporting which could provide best practice examples in order for firms to understand what may be expected from them when making these disclosures. This does not have to be prescriptive guidance.

Question 2: 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?

3. We are supportive of the proposals for the board to report on the company's climate ambitions and transition planning.
4. The ABI has engaged extensively with the Transition Plans Taskforce initiative and is strongly supportive of them. Indeed, 5 members have already published their Transition Plan on a voluntary basis and 87% of firms who responded to a recent ABI survey have active work underway to develop their plan. We see this as a key mechanism to both hold individual firms to account for their management of climate risk but also as an important evidence base to assess whether the UK will meet its statutory climate change targets. Consistency and comparability across businesses and sectors will be critical to this. We would therefore recommend that the Corporate Governance Code recommends adherence to the Transition Plans Taskforce's disclosure framework. These disclosures should be linked to other issues, for example any external social impacts that the transition may create.

5. There is also a lot of ongoing work from other regulators including the FCA and PRA and Government incorporating climate into the Boards work agenda. This includes PRA SS3/19, the work of the transition plan taskforce (TPT) as well as the sustainability work being lead on by the FCA including DP23/1.

6. Given that there is a wide range of work around governance relating to climate ambitions and transition planning, we urge the FRC to ensure that its proposals are aligned to this work. As well as avoiding duplication for firms subject to these additional requirements, the FRC should ensure that every sector that will play a meaningful role in meeting the UK's statutory net zero targets is obliged to report adequately. This is crucial to the insurance sector as the delivery of firms Transition Plans will require interaction with its customers, clients, investees and suppliers.

7. Lastly, we believe that the governance of this process is key. We would therefore recommend that the reference to governance in Provision 1 is not removed but incorporated into the provision.

Question 3: Do you have any comments on the other changes proposed to Section 1?

8. We welcome the suggested changes to Provision 3 concerning reporting on the outcomes of engagement and to Provision 6 on the effectiveness of workforce feedback mechanisms. Reporting this information on a larger scale would be beneficial in assessing where risks may be present and where companies can focus their engagement efforts.

Question 4: 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?

9. We agree with the proposed change to Code Principle K. However, we would suggest that the definition of "*significant*" be extended to all forms of employment, including but not limited to private companies, charities, public bodies or other groups involving substantial time commitments. Current disclosures are often limited to public company boards and can often be misleading when the director in question may in fact have significant private commitments.

10. Further to this, we suggest that disclosure of the information required by Principle K be added to the company website with links in the annual report rather than direct disclosure within the Annual Report.

11. In addition, we acknowledge that the FRC have not set out to prescribe the maximum number of board appointments which can be held by a director. Relating to this, we suggest further consideration by the FRC around proxy advisors and the desire to put a maximum number on board appointments. This is relevant specifically to AGM voting season.

Question 5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

12. We agree with the proposed change to Code Provision 15 which encourages greater transparency on directors' commitments. However, we would suggest the FRC be more prescriptive about which companies would be disclosed as this may be helpful to companies. For example, should appointments to companies registered with Companies House as well as charities be included?

13. We are supportive of disclosures which provide greater transparency on directors commitments. These could include disclosures around the number of board and committee meetings attended or an assessment of an individual's capacity as we feel these would provide a greater level of transparency.

Question 6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

14. We find the outlined proposals support existing regulation. However, as we await the joint DEI consultation paper from the FCA and PRA, it is difficult to say the extent to which these proposals will lead to duplication. We are supportive of the FRC's desire to avoid duplicative disclosures and encourage it to continue to ensure this remains a key consideration.

15. In addition, the recently updated Parker review (2023) announced expectations that each FTSE350 listed company publicly report a target for ethnic diversity of their senior management team, to be achieved by December 2027. Given these expectations, we consider it important to align Provision 24 to include gender balance and ethnic minority representation in senior management and their direct reports to ensure greater alignment and progress in broader representation as is intended with the proposed changes to Principle I.

16. It is important to note that the time lag from consultation to implementation is not necessarily being considered in keeping pace with additional market expectations, as per above. We urge the FRC to take this into consideration.

Question 7: 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?

17. We are supportive of the proposed changes introduced to Principle I of the Code. It is important all protected characteristics are covered, not just gender and ethnicity. It is also important to consider other non-protected characteristics, both to ensure well-informed decision making and to ensure that Boards are genuinely inclusive.

18. However, we would recommend that further consideration be given to how this should be reported – especially for those protected characteristics that are not routinely declared to employers or where individuals may wish not to be identified as having that characteristic (this may potentially include religion and sexuality). This is especially important for Boards – where if there are year-on-year changes on composition, it may be possible to identify individuals from a change in any disclosure.

19. It should also be noted that through the Women in Finance Charter and Business in The Community's Race at Work charter, there are established frameworks to consider targets and progress on these two characteristics. Expectations for other protected characteristics are likely to evolve further in future.

20. Not only is it important to widen our understanding of diversity characteristics beyond gender and ethnicity, but it is also important to create further awareness about intersectionality. Our sector-wide ABI DEI Blueprint highlights the importance of 'intersectionality' – that each individual may experience a number of different factors that could lead to them experiencing discrimination or exclusion. Initiatives targeted at a single group or characteristic need to be incorporated into a wider framework to be effective.

21. We would therefore urge the FRC to ensure that any guidance is clear about what the change introduced by the new Principle is aiming to achieve so it is not interpreted to mean that boiler plate reporting could be reinstated.

Question 8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

22. We support a change aimed at improving clarity on companies approaches to succession planning and board and senior management appointments. Similarly, we agree that improved transparency on the role of DEI targets will hold firms accountable for analyzing the impact their initiatives are having. We recognize that firms will have different starting points – each firm should therefore set its own targets and implement the right strategy for their organisation, and any 'boilerplate' approaches ought to be avoided in reporting as we emphasise throughout our response.

23. The ABI supports and continues to campaign for the Government's Women in Finance charter, and we currently have 43 member companies as signatories. As is evident from the latest annual review, companies that have signed up to the charter report that they are increasingly establishing career development plans for women, as well as toolkits and training to equip leaders building succession plans. We have also made progress in narrowing the gender gap within our member firms' board compositions. According to the 2022 ABI DEI data collection, 32% of board members were women - an increase from 19% in 2018.

Question 9: 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?

24. We are supportive of the proposed adoption of the CGI recommendations. We also acknowledge that a formal

qualification would enhance this area as it will ensure that evaluators are appropriately qualified. We would however like to note that an overly prescriptive process will result in basic or unrefined responses.

Question 10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

25. We are supportive of the proposed requirement for all Code companies to prepare an Audit and Assurance Policy on a “comply or explain basis”. The proposal aligns to the wider focus of the Department of Business and Trade (DBT) and the FRC reforms on enhancing the quality of narrative and non-financial reporting. As stated in our cover letter, we are supportive of the fact that the code remains principles based and emphasises the need for high quality and insightful disclosures. However, we would note that these new requirements to prepare an Audit and Assurance Policy will require focus from management to support. We would urge the FRC to carefully consider the cost benefit of additional assurance needs which may be required.
26. Further to this, firms feel that it is essential for shareholders to be able to engage with Audit Committees on the Audit and Assurance Policy disclosures, should the need to do so arise. However, currently it is not felt that Audit Committee engagement with shareholders should be mandated. Equally at this stage, it is not advocated for the Audit and Assurance Policy to be subject to any form of shareholder vote.

Question 11: 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?

27. We agree that removing Provisions 25 and 26 referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication. However, we would highlight that this will bring some non FTSE350 companies into scope, albeit we acknowledge that these companies have the option to approach this point on a comply or explain basis.

Question 12: 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?

28. We note the proposed expansion of the Audit Committees remit to include narrative reporting where such matters are not reserved for the board. As per the points raised in our cover letter, we do not want to see companies deterred from being ambitious in their sustainability reporting (particularly the transition to Net Zero) by overly prescriptive rules. The proposals to expand the remit of the Audit Committee to include narrative reporting (which includes sustainability reporting and ESG metrics) may be interpreted as potentially preventing the disclosure of information on sustainability strategies by businesses.
29. Sustainability reporting is already part of many firms’ existing reporting practices and is also part of many firms’ Audit Committee priorities. However there are a number of practical challenges to consider. Currently, the availability of data and evidence is gradually improving, which in turn is driving an increase in the sophistication of sustainability reporting, across the whole economy. However, this is not at an equivalent level of maturity to other more well-established aspects of financial reporting. We believe it is important that the code explicitly recognise the relative immaturity of the evidence base on sustainability. It should then promote the publication of ambitious, transparent disclosures on sustainability strategies and actions to improve the maturity of the underlying data and evidence base over time. In particular, it should recognise the importance of Net Zero transition plans (using the guidance produced by the Transition Plans Taskforce). It is vital that firms are given the flexibility to produce iterative disclosures (which may change year-on-year as new evidence emerges), evolve their sustainability strategies over time and provide relevant information to the market in an accessible format.
30. Further related practical challenges to consider include:
    - Unlike accounting reporting standards, which are well established and widely available, reporting standards in the ESG space are non-standardized and not as readily available. ESG matters also cover a wide range and extent of topics.
    - The availability (or lack thereof) and variability of the data. This means that restatements are more common in relation to ESG disclosures, for example, with respect to carbon reporting. Related to this

is the pace of technological advances in ESG-specific record-to-report systems which again would mean that restatements are more common.

- Measuring progress in the ESG space can be more subjective and intangible such that it is inherently more challenging to effectively monitor and oversee (e.g. the focus often being on impact and outcomes for the purposes of monitoring progress).
- ESG and sustainability is a new area, with developing levels of expertise and businesses are still organizing themselves internally to deliver on various requirements. More time might be needed to allow for this internal reorganization and also for Audit Committees to upskill.

31. From a governance perspective, there is a concern that broadening the scope of the Audit Committees responsibilities regarding narrative reporting, including sustainability reporting, could create overlap or duplication of responsibilities with a risk committee or similarly, an already established sustainability committee's responsibilities. Companies which already have risk and sustainability committees should be free to decide how to allocate responsibilities in this area between the risk and or sustainability committees and the Audit Committee. This is already acknowledged in Provision 25 of the existing Code, where the Audit Committee is given the responsibility of reviewing internal controls and risk management "*unless expressly addressed by a separate board risk committee composed of independent non-executive directors*". Similarly, if a company has established a Sustainability Committee composed of independent non-executive directors, it should be free to delegate aspects of sustainability and ESG reporting to it.

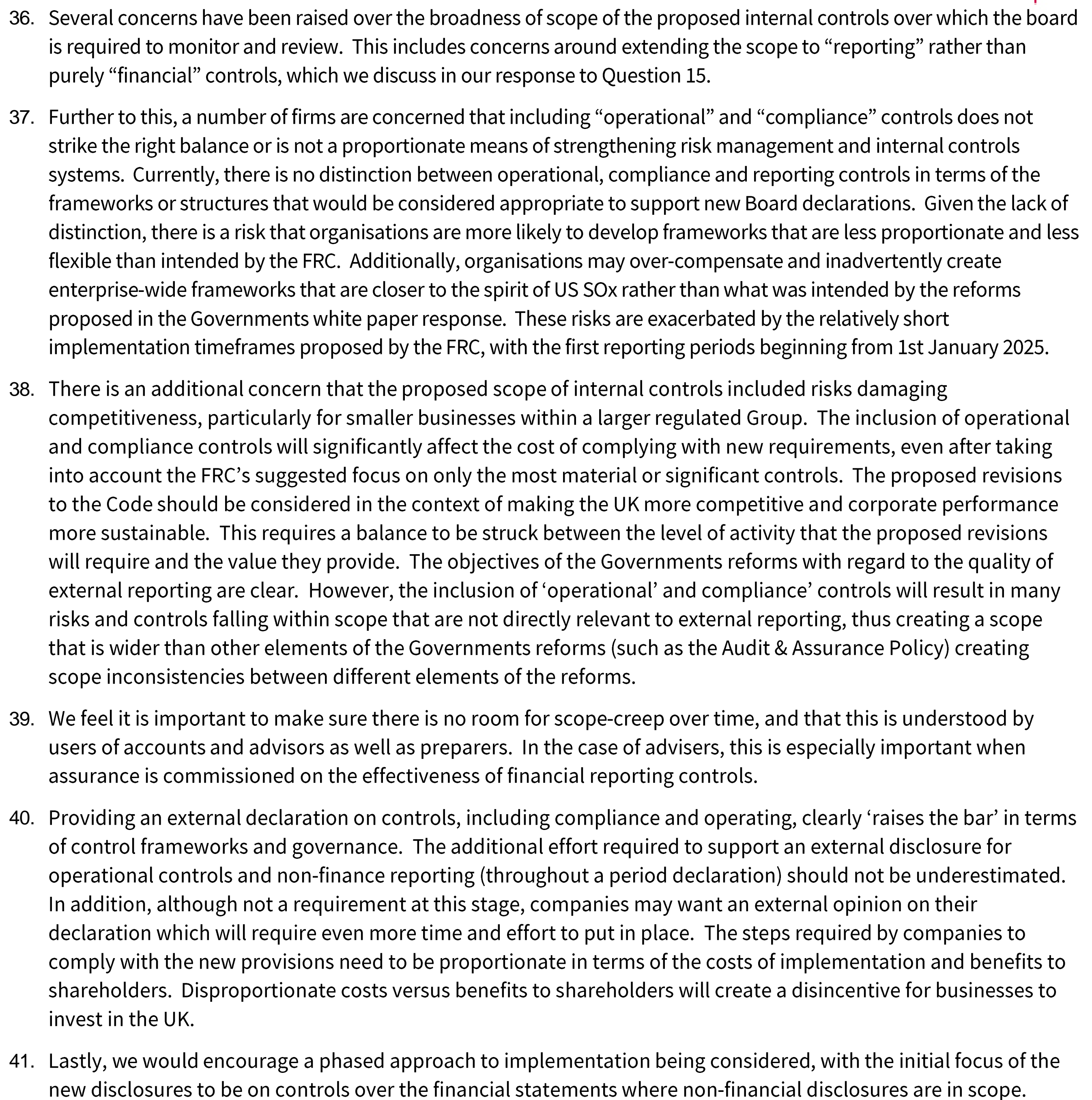
32. We would welcome guidance from the FRC on how this wider remit is intended to connect with existing committees. Specifically with regards to an existing Sustainability Committee, we welcome guidance to ensure that the terms of reference can be clarified for companies where there are already sustainability committees set up to monitor sustainability matters.

Question 13: 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?

33. As mentioned in our cover letter, we support the fact that the Code remains principles based and emphasises the need for high quality and insightful disclosures. We also acknowledge the aims of the FRC to ensure the provisions are proportionate. We believe that having a framework for prudent and effective controls is important and welcome the new provision on a directors' declaration on the effectiveness of the company's internal controls in the Annual report and accounts.

34. We believe that an expectation had built up that this would be a UK equivalent of the Sarbanes-Oxley Act (UK SOx) and the fact that the controls in scope went beyond financial controls in scope of US SOx gave the impression that this was in fact US SOx plus. Recent clarification from the FRC that the provisions in new paragraph 30 are not in any way intended to bring in a UK SOx regime is very welcome. However, we feel it is important that the additional guidance intended to be published by the FRC provide the required clarity over the various proposals in Section 4 specifically around the Board declaration on internal controls. This guidance will be critical for firms as it will allow for proper impact assessments to be performed. We urge the FRC to further consult with companies on this intended guidance. Further to this, we suggest the FRC provide clarity that it does not intend for the proposals to act as a UK SOx framework. There may be stakeholders who interpret the changes to equate to a UK SOx framework which will create additional work. Clarity on the practical steps needed to comply with the new provisions is required and should be included in the intended guidance to be published by the FRC.

35. We acknowledge that the current code already requires directors to monitor and review the effectiveness of "*all material controls*". However, the prescribed focus on "material" controls could impact the ability of firms to maintain existing broader risk-based assurance activity. This could lead to elevated risk in other areas. Related to the proposed disclosure of details of material weaknesses or failures identified as per the proposed Provision 30, there is concern that this disclosure, even if resolved during the period, could make boards uncomfortable where the nature of the weakness is commercially sensitive. We would welcome this being addressed as part of the additional guidance.



36. Several concerns have been raised over the broadness of scope of the proposed internal controls over which the board is required to monitor and review. This includes concerns around extending the scope to "reporting" rather than purely "financial" controls, which we discuss in our response to Question 15.

37. Further to this, a number of firms are concerned that including "operational" and "compliance" controls does not strike the right balance or is not a proportionate means of strengthening risk management and internal controls systems. Currently, there is no distinction between operational, compliance and reporting controls in terms of the frameworks or structures that would be considered appropriate to support new Board declarations. Given the lack of distinction, there is a risk that organisations are more likely to develop frameworks that are less proportionate and less flexible than intended by the FRC. Additionally, organisations may over-compensate and inadvertently create enterprise-wide frameworks that are closer to the spirit of US SOx rather than what was intended by the reforms proposed in the Governments white paper response. These risks are exacerbated by the relatively short implementation timeframes proposed by the FRC, with the first reporting periods beginning from 1st January 2025.

38. There is an additional concern that the proposed scope of internal controls included risks damaging competitiveness, particularly for smaller businesses within a larger regulated Group. The inclusion of operational and compliance controls will significantly affect the cost of complying with new requirements, even after taking into account the FRC's suggested focus on only the most material or significant controls. The proposed revisions to the Code should be considered in the context of making the UK more competitive and corporate performance more sustainable. This requires a balance to be struck between the level of activity that the proposed revisions will require and the value they provide. The objectives of the Governments reforms with regard to the quality of external reporting are clear. However, the inclusion of 'operational' and compliance' controls will result in many risks and controls falling within scope that are not directly relevant to external reporting, thus creating a scope that is wider than other elements of the Governments reforms (such as the Audit & Assurance Policy) creating scope inconsistencies between different elements of the reforms.

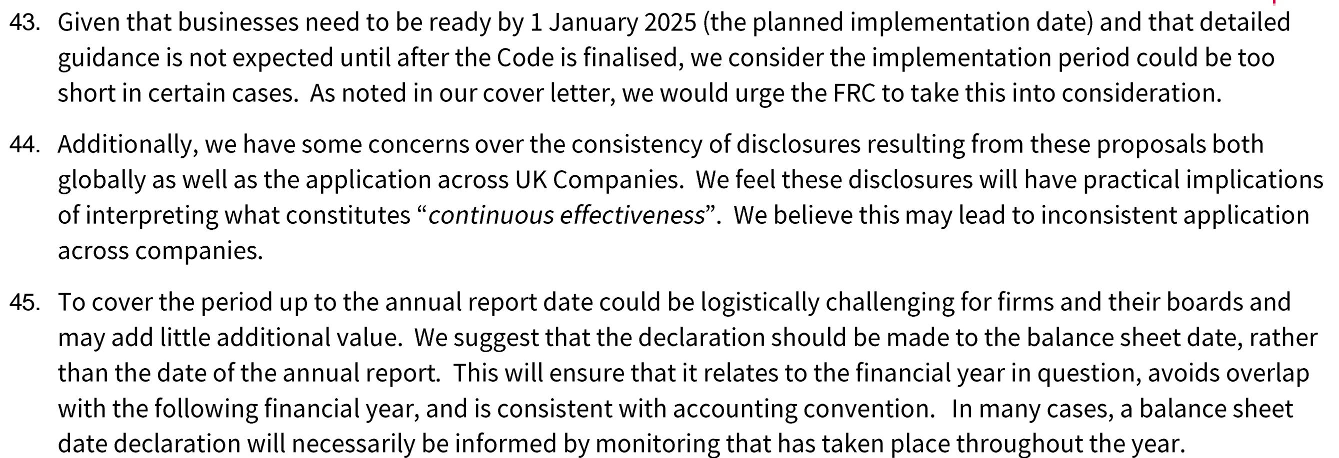
39. We feel it is important to make sure there is no room for scope-creep over time, and that this is understood by users of accounts and advisors as well as preparers. In the case of advisers, this is especially important when assurance is commissioned on the effectiveness of financial reporting controls.

40. Providing an external declaration on controls, including compliance and operating, clearly 'raises the bar' in terms of control frameworks and governance. The additional effort required to support an external disclosure for operational controls and non-finance reporting (throughout a period declaration) should not be underestimated. In addition, although not a requirement at this stage, companies may want an external opinion on their declaration which will require even more time and effort to put in place. The steps required by companies to comply with the new provisions need to be proportionate in terms of the costs of implementation and benefits to shareholders. Disproportionate costs versus benefits to shareholders will create a disincentive for businesses to invest in the UK.

41. Lastly, we would encourage a phased approach to implementation being considered, with the initial focus of the new disclosures to be on controls over the financial statements where non-financial disclosures are in scope.

Question 14: 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?

42. While we understand that assessing control effectiveness is not a point in time exercise, requiring a disclosure on the effectiveness throughout the period does go beyond the requirements of US Sox reporting. We suggest that clarity be given in the guidance on what is meant by "*continuous monitoring*". Currently, the frequency of monitoring required for directors to be confident in making a declaration that material controls were effective on a continuous basis is unclear. Insurers could be considered as having more mature internal control systems and therefore would need to understand how close to the "standard" they already are. Although the current code isn't specific, it appears to be a point in time assessment. In that sense, a declaration based on continuous monitoring is a significant change and will require time to test and embed. It is also important to consider the cost implications that an increase in the required frequency of monitoring will have on firms.



43. Given that businesses need to be ready by 1 January 2025 (the planned implementation date) and that detailed guidance is not expected until after the Code is finalised, we consider the implementation period could be too short in certain cases. As noted in our cover letter, we would urge the FRC to take this into consideration.

44. Additionally, we have some concerns over the consistency of disclosures resulting from these proposals both globally as well as the application across UK Companies. We feel these disclosures will have practical implications of interpreting what constitutes "*continuous effectiveness*". We believe this may lead to inconsistent application across companies.

45. To cover the period up to the annual report date could be logistically challenging for firms and their boards and may add little additional value. We suggest that the declaration should be made to the balance sheet date, rather than the date of the annual report. This will ensure that it relates to the financial year in question, avoids overlap with the following financial year, and is consistent with accounting convention. In many cases, a balance sheet date declaration will necessarily be informed by monitoring that has taken place throughout the year.

Question 15: 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?

46. We acknowledge the aims of the FRC in broadening the scope to include non-financial reporting and while this will be challenging, given the importance of this area of reporting we understand the need for a control framework to support this. However, we have concerns that extending the scope to "reporting" in general, rather than over the controls effectiveness regarding the financial statements only, may lead to inconsistencies in practice. Expanding the directors' statement to cover "reporting" rather than just "financial reporting" **without specificity** could lead to diverging practice and lengthy disclosures which are not comparable across the market as well as being onerous and costly to implement. For instance, "reporting" could be interpreted to include other regulatory reporting requirements such as Solvency II.

47. In addition, the framework for non-financial reporting is much less mature than financial reporting. The pros and cons of expanding the declaration to "reporting" for shareholders and users of the accounts needs further consideration, over a longer timescale before an effective outcome can be achieved. A phased approach to implementation as we mention in our response to Question 13 may help firms to achieve this.

48. We urge the FRC to provide clarity on the scope of 'reporting' controls, and whether the updated requirements will be sufficiently principles-based to allow organisations to define and explain their interpretations of this scope as part of the internal control declarations. Further to this, we encourage the FRC to include in the guidance an explanation of the scope of "*all material controls*". Noting that "*all material controls*" are already in scope of the current code, there is a concern that reporting controls could be regarded as a sub-set of operational controls, leading to a lack of clarity over intentions.

Question 16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

49. We would consider the provision of examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls system within supplementary guidance **extremely important** for the effective application of the new Code. This will help companies to ensure a proportionate and risk-based approach.

50. We suggest that any additional guidance is itself designed in a way that is proportionate to achieving the goals of the revised Code. Firms value the flexibility provided by the "comply or explain" approach. Companies should remain free to explain where they consider non-compliance to be within their best interests. We encourage the guidance to set out examples of what listed companies are currently doing well with their internal controls reporting and to offer good-practice indicators as we have discussed in our response to Question 13. We would also encourage the guidance to define the various terminology used in the provisions such as "*continuous monitoring*" and "*all material controls*" as we have discussed above. In relation to continuous monitoring, it would be helpful to understand whether this includes Internal Audit Assurance. To aid in comparability, it may be beneficial to include a minimum baseline for the

activities needed to demonstrate an effective internal control and risk management system.

51. However, we would highlight that care is needed to ensure that any example methodologies and frameworks included in guidance does not create expectations that only certain frameworks are permissible or sufficient. It will also be important to ensure consistency with other relevant guidance, and collaboration with other bodies may be needed to avoid inconsistency or confusion. An example of this is the Internal Audit standards provided by the IIA, for which a consultation on new Global Internal Audit Standards is ongoing in 2023.

Question 17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

52. We urge the FRC to carefully consider the feedback received from stakeholders around the proposals regarding the definitional issues. There may be differing impacts of defining specific terms or leaving it up to the board to define them and these should be taken into account before providing any set guidance. For instance, if providing an example definition in the guidance, this may lead to users holding that as best practice or the minimum requirement. It is important for guidance to remain flexible and proportionate and not be prescriptive. Where definitions are provided, firms should be given the flexibility in choosing whether to apply these or apply and explain their own definition as set by the board.

53. In terms of the internal control framework, it would be helpful for the FRC to distinguish between the internal control framework and the internal control environment where the framework refers to the design and the environment refers to the operating context. This is particularly relevant for considering the impact of a material weakness. If there is a material weakness in the internal control framework, this will affect the whole design, whereas a material weakness in the environment potentially has a more isolated impact.

54. Additional guidance and or examples on the following would be welcome:
    - what is considered to be "material" in practice, given this is not clearly defined.
    - the application of "materiality" as part of the new proposed requirement for Board declarations to be applicable up to the date of the annual report.
    - Definitions of terms such as "assurance" (e.g. to what extent does it include oversight teams within the 1st line), and those used in defining scope such as "operational" and "compliance". It will also be important to avoid inconsistency with definitions included in other relevant guidance from other regulatory bodies.

55. Relating to "*effective risk management and internal controls system*", it would be preferable for the FRC to provide guidance on the following, rather than any prescriptive criteria:
    - the definition of 'effective' such that it is clear what exactly is required to demonstrate an 'effective' risk management and internal controls system beyond the existing frameworks to ensure compliance with the requisite regulatory requirements (e.g., Solvency II, FCA Sourcebooks, PRA regulations, CQC and other medical regulations.
    - the nature of the achievements or outcomes to be considered indicative of an effective system or framework.

Question 18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

56. We like to see the following areas in relation to risk management and internal controls covered in the guidance:
    - Examples of what listed companies are currently doing well with their internal controls reporting. We are aware that many companies are reporting on this currently and doing it well so including this in the guidance would be welcome.
    - The expected frequency of control testing to answer the question of whether all material controls are expected to be tested in each reporting period.
    - The role of UK and overseas subsidiary boards in Code companies that report as a Group.
    - Confirmation that firms will be given the flexibility to form their own assurance strategies to support

disclosures, rather than assurance expectations being specified by the FRC.

- How to address the potential commercial risks of certain disclosures for example where disclosing a material control weakness could be exploited by criminals and/or competitors (as would be the case with information security vulnerability for example).
- The expected breadth of controls coverage - for example in the case of reporting controls whether organisations would be expected to map processes and controls all the way from transaction/data initiation through to external reporting.

Question 19: 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)?

57. We agree that the current Provision 30 should be retained so that all Code companies report on the adoption of the going concern basis of accounting. We have no further comments related to this.

Question 20: Do you agree that all Code companies should continue to report on their future prospects?

58. We agree that all Code companies should continue to report on their future prospects and have no further comments related to this.

Question 21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

59. We agree that the proposed revisions provide sufficient flexibility for non-PIE Code companies. We have no further comments on this.

Question 22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

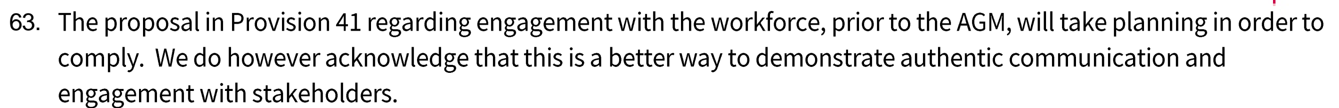
60. We agree that the proposed revisions strengthen the links between remuneration policy and corporate performance. We are supportive of the suggested amendments to provisions P, Q and R. We advocate the need for increased transparency of remuneration and would particularly emphasise the need for simplicity. We note that 'simplicity' under provision 40 has been removed from the Code, we would prefer to see this concept retained and included, for example under the new provision 34.

Question 23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

61. The disclosure of the use of malus or clawback in respect of a current or former director is already a requirement. The proposed rolling 5-year look back would be a new requirement but would contain information disclosed in previous reports and thus we acknowledge the benefit to shareholders of the proposed changes. We would however note that the use of malus and clawback over a 5-year period is relatively rare so question whether there is value in including this disclosure. We would also like to highlight that the Remuneration Committee will have its own definition of what malus and clawback includes and this should be outlined in the guidance for comfort.

Question 24: Do you agree with the proposed changes to Provisions 40 and 41?

62. We acknowledge the removal of Provision 40 to prevent boiler plate reporting. As already mentioned in our response to Question 22 above, we believe there is a need to include 'simplicity' in some form within the proposed changes. This is the only element within the old Provision 40 that we do not consider to be adequately covered with the other proposed changes. Although we note that there is a desire to remove duplication with the removal of the explicit reference of pay ratios and pay gaps within the Code as companies report these elsewhere, we still believe these are an important element to consider when setting a remuneration policy. We would suggest these two references are included as an example within bullet 3 of Provision 41, or as a footnote and that these elements are included within the definition of "*overall company pay policy.*"



63. The proposal in Provision 41 regarding engagement with the workforce, prior to the AGM, will take planning in order to comply. We do however acknowledge that this is a better way to demonstrate authentic communication and engagement with stakeholders.

Question 25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

64. It is important that Remuneration Committees set out the factors taken into account in determining appropriate remuneration outcomes, including workforce and pay conditions. Additional narrative on pay ratios and pay gaps could potentially provide a more considered element to pay appropriateness than disclosed elsewhere in reporting. However we would like to note that specific requirements to reference pay ratios and the gender pay gap could be seen as potentially duplicative and can risk leading to "boilerplate" disclosure that detract from the key relevant circumstances, factors and context specific to each company. The FRC should consider strengthening the reference to pay gaps and pay ratios but ensure that this does not create duplication or lead to "boilerplate" disclosure. The disclosures could be expanded to explain how ratios showcase appropriate pay outcomes.

Question 26: 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?

65. We believe it would be helpful to update the Code with wording that enables it to adapt to the developing regulatory framework for data, including AI. We suggest that consideration is given to areas where AI could be used in future or may already be used or relied upon in the production of annual reports. The FRC could consider providing specific Guidance on standards of evidence and traceability of sources.