lloyd's market association

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Lloyd's Market Association
Suite 426 Gallery 4
One Lime Street
London EC3M 7DQ
T. 020 7327 3333

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By Email: codereview@frc.org.uk

Response to Consultation on the UK Corporate Governance Code 2023

Lloyd's is a society of members, incorporated under the Lloyd's Acts 1871–1982, which operates as a general insurance and reinsurance market and is dual-regulated by both the PRA and FCA in the UK.

The Lloyd's Market Association (LMA) represents the 51 managing agents at Lloyd's which manage the 91 live syndicates underwriting in the market, and the 3 members' agents which act for providers of third party capital backing syndicate underwriting. Managing agents are also dual-regulated and members' agents are regulated by the FCA. For 2023 premium capacity for the market is in excess of £50 billion.

The LMA recognise the importance of the current UK Corporate Governance Code and values its concise wording and principles-based, "comply or explain" approach. It is worthwhile to conduct a periodic review so that the Code can be refined and kept up to date. Any proposed changes, however, should primarily be a response to established trend changes in the business environment rather than one-off high profile incidents. A review should always have the objective of maintaining the UK's reputation for a trustworthy reporting, risk management and control regime which is proportionate and internationally competitive. We are also keen to ensure that changes in the Code can be applied effectively within the unique structure of the Lloyd's market, including the oversight role of the Society of Lloyd's.

We welcome the opportunity to comment on the proposals in the consultation. As this response is submitted on behalf of our membership, we do not provide answers to the individual questions in the consultation but provide some overall comments which reflect the factors that are likely to impact the market as a whole or a major proportion of the market participants. The most relevant question numbers are noted alongside each comment below.

The managing agents in the market include three UK listed organisations (Beazley, Hiscox and Lancashire) and these three companies may submit their own responses with comments on the individual questions. They have also contributed to this response.

We were pleased to note that, following the BEIS consultation last year on "Restoring trust in Audit and Corporate Governance", syndicates in Lloyd's continue to be outside the scope of Public Interest Entities (PIE). However, we estimate that, in addition to the 3 listed companies, there will be between 10 to 15 non-listed syndicate management companies in the market for which the Resilience Statement and Audit and Assurance Policy aspects will apply by virtue of either the £750m/750 employees test or through being a material entity in a UK group which exceeds those thresholds. The Code, in conjunction with the Statutory Instrument, are therefore likely to have the effect in practice of bringing entities into scope which were perhaps not intended.

The syndicate management companies, or managing agents, are also highly regulated through the PRA, the FCA and Lloyd's. The regulatory framework for these companies is the Solvency II regime

which includes the Pillar 2 governance and risk management requirements. It is likely that, if these companies were also in scope of the Code, that there would be significant duplication of compliance effort from two non-aligned frameworks.

Aside from the potential impact on the companies participating in the Lloyd's market, the proposed changes to the Code represent a significant expansion in compliance requirement for any company in scope (see more detailed bullet points below). It is our view that the very largest listed entities may well already meet much of the risk management, internal control and reporting requirements and so may be able to absorb the changes at a relatively marginal additional cost. Our concern is for the small and mid-sized listed entities that form the bulk of, for example, the FTSE 250/350 and the non-listed companies that breach the £750m/750 employees test. For these organisations the new Code represents a much more significant step from their current compliance effort and cost. We are of the view that the Code will place an onerous burden on such companies which would be in excess of that required in any other international business environment, including the US. These mid-sized listed entities are also likely to be those with the greatest potential to grow and contribute to the UK's economic success and so we believe these proposals would act as a constraint to growth and affect the attractiveness of the UK business environment.

We comment now on some of the specific proposals in the consultation with suggestions on how they might be refined or improved.

- The £750m/750 employees threshold for application of an Audit and Assurance Policy (AAP) and Resilience Statement appears to be set at a relatively low level, at least in the context of highly regulated financial services entities, and would include organisations for which the new Code requirements are not well suited and would be a significant additional burden. With the threshold set too low there is a danger that a Code suitable for the largest companies becomes a disproportionate burden for the majority of mid-sized entities, affecting the competitiveness of that vital sector of the UK economy. We suggest that the threshold is either raised or that a two-step threshold is introduced so that the requirements on the mid-sized, sub £1bn companies, can be more flexible and proportionate.

  [Questions 10,21]

- Provision 30 of the Code requires a declaration from the Board that they can reasonably conclude on the effectiveness of both financial and non-financial controls throughout the period. The assurance procedures required for a declaration of this nature are significant and this places the compliance bar at a level at which a "comply or explain" approach becomes unworkable. It is hard to see a circumstance in which a company's Board, despite having a satisfactory explanation, would not suffer some adverse investor/stakeholder reaction. If the application of the Code loses the principles-based, comply or explain approach that is valued now, it is likely to act as a disincentive to talented individuals to taking on the roles of director or INED. The current code is widely recognised as striking a good balance of robust requirements while being clear, concise and principles driven.

  [Questions 4,5,13]

- We see the potential for the declaration requirement to have a number of additional consequences. Firstly, it is likely that auditors will look to place reliance on a costly Board declaration before signing their audit opinion with the possible unintended consequence of weakening the independence of the audit opinion. Alternatively, auditors may set out to re-perform the assurance work underpinning the declaration resulting in further additional costs to companies. Either approach would produce the opposite effect of reducing trust in audit rather than restoring it. Secondly, given the level of assurance Board directors would be expected to give, there is likely to be an increase in the costs of providing Director and Officers insurance.

  [Question 13]

- Provision 30 also requires reporting on the operation of risk management and controls 'throughout the period'. We suggest that it would be more effective and proportionate for reporting to be as at the balance sheet date. In particular for insurance companies operating under the Solvency II regime this would remove much of the overlap and duplication of compliance as the Solvency II regime includes well embedded requirements to operate and monitor risk management and governance procedures on an ongoing basis. If the requirement for 'throughout the period' reporting remains it would be sensible to provide guidance that firms that are satisfactorily meeting requirements under a framework such as Solvency II are considered to be complying.

  This raises a general point about the interaction between the Code and other regulatory and compliance requirements on firms from other sources. The Code and appended guidance should explain how requirements from different regulators should interact so that firms can operate one integrated risk, control and reporting procedure and avoid the cost of meeting multiple, overlapping but largely duplicative regimes. We are also aware of a number of different related consultations on reporting matters as well as a proposed Statutory Instrument. Although this may have been deferred, it would be sensible to provide an opportunity to consider all the proposals prior to finalisation to ensure that they work together as an integrated, efficient regime for companies, Boards and audit firms.

  [Question 14]

- Related to the previous point, the new Code requires "continuous monitoring" of the operation of all controls. The intention behind this is worthwhile but it is not clear what the expectations are and what compliance would look like in practice. A vaguely defined phrase such as this may lead diligent firms to over compensate, leading to significant additional cost, while other firms may just pay lip service to it. Either way, the worthwhile intention behind the provision is not achieved. If this requirement is to remain and be proportionate and effective, firms would need significant guidance, examples and case studies for application. In practice, the Code would be more effective if the reporting was as at the balance sheet date with supplementary guidance provided on how ongoing monitoring is expected to be performed. As noted above, for financial services and insurance this requirement is largely covered by the existing regulatory frameworks such as Solvency II. It would be sensible for the guidance to clarify that firms which are satisfactorily meeting the requirements of frameworks such as Solvency II are considered to be complying with the Code in this respect.

  [Questions 14,16]

- The Code expands the scope of the risk and control monitoring to include all non-financial controls and introduces additional non-financial narrative reporting. We think it is a mistake to apply a framework designed for long standing and well understood financial controls and reporting, to non-financial controls and reporting. We suggest that the Code is initially limited to financial reporting controls only.

  Firms are operating in an environment in which there is a significant expansion in newly implemented or about to be implemented non-financial reporting. This is covering topics such as ESG, sustainability, resilience, diversity and inclusion, nature impact, remuneration and performance metrics, and emerging risks. This is a rapidly evolving area in which firms are providing more and more forward looking information across these topics for a broader range of stakeholders. In many cases it is not yet clear what stakeholders will find useful and how the information will be used in assessing business performance. In particular the potential impact of expansion of non-financial and forward looking information on stock prices is not at all clear.

In this context, we do not consider it appropriate to combine financial and non-financial reporting and controls together within the Code. It would be sensible to focus initially on financial controls and develop a monitoring framework for non-financial reporting and controls over a longer period, in conjunction with other international regulators and with the benefit of a clearer understanding of how stakeholders use the information. It may be useful for the Code or the related guidance to explore defining the expected role of each key stakeholder and how they can engage with organisations, whether through the AGM or via other routes. For regulated financial services entities, the non-financial reporting is already subject to audit committee and/or risk committee oversight, so we would expect the content to be able to evolve in a controlled way in response to stakeholder demand and usage.

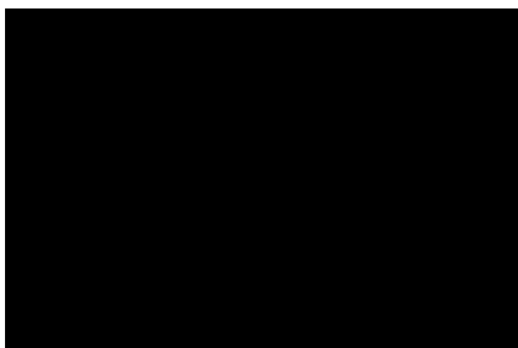
As a final observation on the expansion of non-financial reporting, there must be a much deeper cost benefit exercise performed to determine whether the recent significant increases in volume of material published in annual reports at considerable cost is truly providing value and benefit to users of accounts.

[Questions 2,6,12,15,20]

- Overall our view is that the reforms would benefit from a period of pause and re-assessment, with further engagement and consultation to ensure the framework continues to be robust but can operate with a principles-based, comply or explain approach appropriate to the full range of company sizes and keeps the UK internationally competitive.

  If the proposals remain as they are then the proposed implementation timeframe is too short. The detailed guidance is not yet available and will need to outline expectations consistent with a comply or explain approach and not be prescriptive. We would also like to understand how the deferral of the Statutory Instrument affects the Code proposals and timeframe as full implementation is likely to be dependent on statutory changes being enacted. Consequently, we suggest that implementation from 1 January 2026 would be the earliest practical timeframe. Alternatively, a phased implementation could be considered with focus on financial controls and reporting at the balance sheet date first, while a proportionate and internationally competitive framework for non-financial control monitoring and reporting is developed over a longer period.

We appreciate the opportunity to comment on this consultation and would be happy to discuss any aspect of our feedback with you, or convene relevant experts from the Lloyd's market to engage with you.



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