THE INVESTOR FORUM

David Styles
Director, Corporate Governance and Stewardship
Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS

13th September 2023

Dear David,

Consultation response for the Revisions to the FRC Corporate Governance Code

The Investor Forum was set up at the end of 2014 by the investment industry to help facilitate an enhanced dialogue between investors and UK issuers. We have 55 Members who own more than a quarter of the FTSE All-Share Index, and have a unique insight into the engagement capabilities and key stewardship priorities of leading investors.

As an organisation, we aim to enable effective corporate governance and investor engagement in order to enhance market efficiency and position stewardship at the heart of investment decision-making. We appreciate the opportunity to share our feedback in response to the consultation on proposed amendments to the UK Corporate Governance Code.

Many investor bodies, representing the differing investor perspectives – from retail to institutional, and from domestic to global - will no doubt be providing comprehensive responses to this consultation and we have therefore restricted our comments to those areas where we have direct experience as practitioners who facilitate collective engagement by investors with UK-listed companies.

Context

With recent commentary on the friction between boards and shareholders and the challenges facing the UK equity market, this is a critical time for UK capital markets. We are concerned that the terms of reference for the update to the Code might not be aligned with the current focus of market practitioners and the wider array of policymakers, through the Capital Markets Industry Taskforce (CMIT) and other initiatives, to promote well-functioning capital markets in the UK.

Changes to the Code will need to balance the value of a tightening of guidance, to enhance effective governance, against the risk of introducing significant reporting and engagement requirements, that may compound existing concerns about so-called 'tick-box' governance.

We set out below our key concerns. Investors will welcome changes that align interests, increase the focus on sustainable value creation and result in the provision of decision-useful information and enhanced engagement. They will find less value if these proposed changes are perceived to be, or interpreted as, 'prescriptive rules' that result in an increase the volume of reporting merely in order to evidence process.

Key issues

We highlight four issues which require further attention. We would like to see the FRC:

1. Encourage best practice rather reinforce the perception of ‘comply or else’

   We fully support the ‘comply or explain’ principle that has long been a feature of the UK’s Corporate Governance Code. However, we are concerned that the proposed revisions reinforce the widely held perception amongst corporates of ‘comply or else’, given the focus on reporting rather than sustainable value creation.

   We encourage the FRC to further emphasise the flexibility that the Code allows, and encourage boards to be confident both to do, and to explain, what is right in their individual circumstances in order to promote the long-term success of the company. In such circumstances, investors would of course expect that companies provide substantive, rather than boiler plate, explanations.

   We believe that institutional investors are much more accepting of nuanced explanations of divergence from the Code, in appropriate cases, than corporates and their advisers appear to believe. A review of investor Stewardship Code reports confirms that investors are fully prepared to make judgements on a case-by-case basis.

2. Ensure that the Code promotes well-functioning markets

   In terms of sequencing and timing, we note high levels of current activity in the debate about the effectiveness of UK Capital Markets, with FCA reviews, the work of CMIT and the reform agenda set out in the Mansion House speech. The Corporate Governance Code plays a central role in encouraging best practice, and it is therefore critical that revisions to the Code contribute to the desire to ensure that UK capital markets are vibrant and represent attractive venues for companies.

   We urge the FRC to take sufficient account of the evolving agenda, in particular the current rich debate on the role and value of our marketplace, and ensure that the revisions to the Code go beyond embedding recommendations from the ‘Restoring Trust in Audit and Corporate Governance’ report to consider this wider fast-moving agenda. We would therefore like to highlight the need to sequence the introduction of proposed changes to ensure that the Code does not act as a disincentive to companies listing here, given the perceived increase in the reporting burden required to comply with the revised Code.

   In addition, we note the increasing inclusion of the language of ‘ESG’ investing in the Code. Given the existence of so many other reporting initiatives, our sense is that retaining the focus on Corporate Governance and leaving the detailed specification of E&S reporting to other initiatives, will allow a more natural evolution and a pathway to include emerging issues over time.

3. Recognise the unintended consequence that can arise from ‘outcomes’ focused reporting

   We note the requirement to report on the ‘outcomes’ of governance, and caution against the unintended consequence of this. The introduction of such an ‘outcomes’ focus with the Stewardship Code 2020 has increased the focus on reporting activity and diverted time away from the overarching goal of creating and sustaining long-term value. In our experience, the dialogue between companies and investors in the UK has been negatively impacted by a crowding out of value-added ‘quality’ conversations by a relentless focus on the ‘quantity’ of interventions. Chief amongst these issues, over many years, would be Remuneration.

   The introduction of further reporting to evidence activity risks further inflating the size of the Annual Report, adding a series of generic statements which would be unlikely to help investors in either their capital allocation decisions or stewardship activities.

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4. Prioritise material and effective investor/issuer dialogue

   We welcome the encouragement for companies to increase their engagement with shareholders. We believe that the Investor Forum can play a critical role in this new landscape such that the desire for additional meetings does not become overwhelming for both sides.

   However, we feel that any move to 'compel' engagement between investors and issuers is not wise, and would likely lead to frustrations and inefficiencies on both sides, once again diverting focus from material issues and value creation. We agree there is a need to improve the dialogue but believe there are other ways in which this can be achieved without imposing a rigid requirement to have multiple individual meetings on a given issue.

   In particular with regard to Audit Chair meetings, while we note the FRC's concerns we simply have not observed a material demand from investors to have this dialogue on an ongoing basis at a company-by-company market wide level. Where investors have had concerns, tailored engagement and debate with Audit Committee Chairs has always been possible and appropriate to the individual circumstances. Many investors have taken the view that it borders on micro-management for them to be routinely involved in the approval of the audit plan, and would be concerned at the risk of 'becoming a backstop to the Audit Committee' in the way that many feel they have become in relation to Remuneration Committees.

   We believe that it should be up to investors to decide who to meet with at investee companies, as determined by their investment mandate and approach.

Conclusions

We believe that empowering Boards to act in a manner that promotes the long-term success of the company should remain at the heart of the Code, and that the Code plays a valuable role in establishing best practice and encouraging time and resources to be directed in a manner which protects and creates value for stakeholders. We believe that few of the proposed revisions are likely to result in the provision of additional decision-useful information for investors.

The FRC has been clear in its commentary that a 'comply or explain' approach can be taken to the provision of the Code, and investors have stated in their Stewardship Reports that they are willing and able to focus on individual company approaches. Boards, however, continue to believe that their response to the Code should be 'comply or else', and we believe there is a risk that the proposed revisions embed rather than correct that perception.

We believe that the FRC will need to reflect carefully on the feedback that it receives in order to ensure that changes to the Code take into account the broad range of initiatives that are currently under consideration. If necessary, and in all probability, the timetable for announcing revisions to the Code will need to be revised in order to ensure that these revisions contribute, alongside other reforms, to well-functioning UK capital markets.

We would of course welcome the opportunity to discuss our views with you further.

Yours sincerely,

[redacted]

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