

The UK Corporate Governance Code Consultation

RESPONSE FROM:

United Kingdom Shareholders' Association



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Due to time constraints, we have not been able to get final approval from the ShareSoc board for supporting the UKSA response to the consultation. However, ShareSoc will review the UKSA response in detail over the coming days and will contact the FRC separately if they wish to add their support.

The UK Corporate Governance Code Consultation

To: The Financial Reporting Council

Email address: codereview@frc.org.uk

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1. Introduction

1. We continue to see the Code as the benchmark for good governance in UK corporates and do not want to see any relaxation in the high standards for holding UK companies to account.
2. We need boards/all directors to be held accountable for carrying out their duties and responsibilities to their shareholders. They are closest to the business so are always best placed to know and explain what should be and was done. Only boards/directors can provide the context of the outcomes of those decisions and actions. We do not expect boards to pass those duties and responsibilities on to other parties such as those providing assurance (mainly auditors) or those providing capital (shareholders and lenders).
3. Therefore, we welcome the FRC's new draft Corporate Governance Code (the Code). By setting out some of the important aspects of audit and governance reform, we feel, at last, that boards will have a better understanding of their role and obligations to shareholders and the wider stakeholder cohort on important matters such as the purpose and requirements of assurance and the wider implications of risk and control.
4. Consequently, we support the focus of the consultation on internal control, assurance and resilience that address Restoring Trust in Audit and Corporate Governance reform issues. We expect better information about risk, control and resilience that demonstrates their contribution, whether successful or unsuccessful, to company outcomes.
5. We need a consistent definition and application of materiality across corporate reporting, including in respect of governance requirements. This is to resolve disclosure problems, often boiler-plate statements supported by too much irrelevant information without enough relevant information and badly worded/communicated information.
6. We ask that the FRC do not make changes to the Code's Introduction, including Reporting on the Code and Application, as the FRC have not issued a marked up version of this bit of the Code.
7. We request that the FRC include a principle and/or provision for IT governance. With the increasing reliance on IT for business success, we believe companies need to have strong IT, data and cyber governance in place before companies can begin to address the many concerns related to AI.
8. We are also aware of the recently published letter in the FT from General Council ([Lawyers concerned about 'extraordinary' FRC code omission | Financial Times](#))

[\(ft.com\)](#)), asking for the inclusion of General Council in the Code. In principle, we agree that the FRC should consider this.

2. About UKSA

UKSA (United Kingdom Shareholders' Association)

9. UKSA is the oldest shareholder campaigning organisation in the UK, with 12,000 members. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.
10. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.
11. UKSA was formed to provide individual shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.
12. We build relations with regulators, politicians and the media to ensure that the voice of individual shareholders is reflected in the development of law, regulation, and other forms of public policy. See www.uksa.org.uk

3. Answers to your numbered questions

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

13. Broadly speaking, yes, but we feel there is too much emphasis on the workforce relative to the wider stakeholders. To act as a balance, we would like included in Section 1, a new principle that follows on from Principle B: “Measures are in place to create the best environment to optimise customer and supplier engagement to support the company’s long-term sustainable success.”
14. We believe that this could prevent negative outcomes recently experienced by Coutts, where scant regard was paid to some customers whose legally held opinions were at odds with the views of the workforce.
15. Having given more focus to the workforce, we were surprised to see the removal of one of the important powers given to them in the current Principle D: “The workforce should be able to raise any matters of concern.”. This power is also a key control for identifying weak or criminal practice. We recognise the wording in Provision 6 includes a mechanism for raising workforce concerns but is not nearly as strong as having it as a principle. We prefer it reinstated as a principle.

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?

16. Yes. As ESG becomes increasingly important to society, the Code is now a reminder on the wider fiduciary duties of companies.

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

17. Re principle D, “When reporting on its governance activity the board should focus on outcomes”: from a governance point of view, we support the emphasis on ‘outcomes’ but not at the expense of ‘objectives’.
18. The concern is that too much focus on outcomes may weaken other aspects of governance as it ignores the steps in between, from ‘purpose’ to ‘delivery’. Actual outcomes can differ to what was intended when objectives were set, so this will need explaining. Governance is all-embracing and its outcomes are aligned to, as well as influencing the alignment of, purpose, values, strategy, objectives, behaviours, risk appetite and tolerances, operations and outcomes.

19. But we do recognise that 'purpose' seems difficult for some companies to define well, and that objectives are often presented in vague, aspirational terms that are hard to measure, making it easy to game. From a strategy perspective the board should certainly be setting objectives and measuring performance against them.

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?

20. In part.
21. We are not happy with the deletion of 'to achieve objectives' so would like it reinstated. Board evaluations, whether from internal or external sources, will become more difficult, in fact become too qualitative (we are all such 'good chaps', of course we work well together! An issue demonstrated by the current Coutts/Nat West de-banking and communications problems), without also having some quantitative measure, like 'achieving objectives'.

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?

22. Yes. We agree with the changes to Provision 15.

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

23. Yes.

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?

24. Yes.

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

25. Yes.

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?

26. Up to a point, probably because of semantics rather than substance.
27. For some of us, they appear to be complementary rather than the same. The existing FRC guidance on board evaluation appears to prepare the board for an evaluation whilst the CGI's guidance is how to evaluate the board against the expectations of the Code.
28. For others, they like the adoption of the GCI's 'Board Performance Review' in place of 'Board Evaluation' on the basis that the Performance Review is intended to encourage a forward-looking process of continuous improvement.
29. For the remainder, they interpret 'performance' as backward-looking, covering what was achieved previously, whilst 'evaluation' is forward-looking by examining how well the board works together and what can be done to improve effectiveness.
30. Other sound guidance and evaluation tools also exist. If companies prefer to use these in preference to the CGI's and/or FRC's guidance, we assume that they can do so on a 'comply-or-explain' basis.
31. We would like the Code to reinforce this by stating that the Review is intended to facilitate and promote continuous improvement.

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

32. Yes. All Code companies are PIEs in our opinion.

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?

33. Yes, but several of us are uneasy about the Minimum Standard on the basis that:
34. It implies that the audit committee should be directly involved in the running and management of the audit tendering process. In many cases the audit committee members will have neither the time nor the competence to do this themselves. The Minimum Standard should encourage them to seek expert input for this process using internal or external resources.

35. We also believe that the suggested change to the code - Appendix A, page 43, third bullet, “promoting effective competition during the tendering for an external auditor, to support audit market diversity” - will be difficult for audit committees to achieve in any meaningful way given the ongoing shortage of competition in the audit market. We believe that a fundamental rethink is required in this area.
36. We are worried that the audit committee is being tasked with far more than it can realistically take on. A fundamental review of its remit and how it can best discharge its responsibilities (all of which remain important and legitimate) is needed. Expansion of the audit committee’s role to include narrative reporting (which itself will include sustainability reporting, discussed below) adds further weight to our concerns.
37. Addressing the issue of Audit Committee workload and the unrealistic assumptions implied about the breadth of skills and capabilities of the Audit Committee members is important. As it stands it has the potential to undermine the credibility of the Corporate Governance Code (particularly when ESG oversight responsibilities are added in). We suggest that this section of the Code is ‘toned down’ and that clearer and more pragmatic guidance is produced on how the Audit Committee can go about managing these responsibilities.

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?

38. Yes as this is the key committee to provide oversight. It has accountability to the board for all things that assess performance, risk and control.
39. But we are concerned that the Consultation’s paragraph 50 is making some big assumptions about audit committee capability and adaptability to meet sustainability reporting requirements. Paragraph 50 assumes that current audit committee capabilities exist to the breadth, depth and relevance that can then be seamlessly applied to sustainability reporting.
40. We believe few audit committees will have sufficient resources so they should be allowed to delegate the work to an existing or new body/committee, reporting to them for ESG, especially if skills lie elsewhere in the organisation or even outside, and/or time does not permit the audit committee to do this effectively.
41. You refer to ESG and sustainability (paragraph 45). What does the FRC mean by them? Where is one an extension of or the complement of the other?

42. We want included in the Code that it would be good practice for companies to distinguish between: i) the impact they have on the environment and ii) the impact that climate change is having/is likely to have on them.

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?

43. We mainly agree. There is significant reporting risk across the front and back portions of the annual report. To avoid the likelihood of misreporting, we want better clarity over the financial control aspect and materiality.
44. The proposed Provision 30, “The monitoring and review should cover all material controls, including operational, reporting and compliance controls”, omits financial control. We want ‘financial control’ retained as a separate category to support how potential financial shortcomings and risks are dealt with prior to the creation of the financial report. Financial control may overlap with, but differs from, operational, reporting and compliance controls.
45. Reporting is now made up of both financial and non-financial items. Given the importance of appropriate controls and our desire to have non-financial controls placed on the same footing as financial controls, the entire control framework should be assured by third parties, otherwise companies are marking their own homework. The extra cost is swamped by the cost of rectifying control failure.
46. We agree with your assessment in paragraphs 56-57 of the consultation. You state that “some companies report on the effectiveness of their risk management and internal control framework in their annual reports by providing a statement that their systems have been effective during the year or that no material weaknesses have been identified” and that “Currently there is a lack of information about the risk management and internal control systems operated by companies”.
47. An underlying reason, we believe, is that there is neither a Code definition of materiality nor a requirement in the Code for companies to define ‘materiality’ or what is ‘material’. The consultation refers to them 27 times, covering ‘business relationships’, ‘controls’, ‘fraud’, ‘risks’, ‘uncertainties’ and ‘weaknesses’.
48. Paragraph 66 provides a list of material areas but the list is the FRC’s examples and not included in the Code. Several of us want a Code definition, based on the IASB definition with the FRC’s list of material areas included. We want the Code to require companies to define ‘materiality’ from their perspective (although we recognise their homemade definitions may be self-

serving, not informative). If we have the former in place, then companies can 'comply or explain' using the latter.

49. Paragraph 66 also states that "the revised Guidance will discuss what may constitute a material weakness, but it will ultimately be for the board to determine which weaknesses are material to their specific situation and should be reported in the annual report". This is another reason for why the Code must define materiality and require all Code companies and also all PIEs to 'comply or explain' how they define 'materiality' for each context mentioned in Paragraph 66.
50. Without any definition, we cannot ascertain whether opportunities, risks and impacts from any source are being managed appropriately.
51. See also our answer to Q15.

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?

52. Our conclusion is that if it is truly continuous monitoring, declarations are provided independently of the annual report, e.g. on a quarterly basis (which may or may not coincide with quarterly and half-yearly reporting), with one of those dates coinciding with the B/S date. Underpinning thoughts:
53. We are torn here, mainly because we do not know how significant the different dates will make.
54. We feel it should be consistent with the reporting requirements of everything else that goes into the report but, at the same time, we are not sure what that means in practice. It is a question of how backward-looking and forward-looking the various parts of the annual report must be?
55. We recognize that a 'point-in-time' snapshot of the company's situation, such as the date of the B/S, is useful to have to be able to assess everything in one context, especially if the declaration contributes materially (assuming it has been defined) to the position of the B/S.
56. For the 'resilience' and 'going concern' statements, making the declaration the date of the report will be more relevant to get some forward-looking information but it will still be historic by the time the report is published.

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?

57. We would like the word 'reporting' to be used but we would like it to be made explicit that this covers financial reporting and non-financial reporting. We do not want to diminish financial reporting but we do want to increase the emphasis on non-financial reporting. Reporting covers more than financials.
58. See our response to Q13.

Q16: 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?

59. The guidance should include clear examples of appropriate methodologies and frameworks. We agree that these should not be prescriptive. The guidance should steer companies away from making bland statements of process i.e. 'We did A, we did B, we did C....' without any meaningful comment on why these activities were carried out, what they revealed and what action the company took as a result. For illustrative purposes' it might be helpful if the guidance gave examples of good practice and examples of what would be considered inadequate. The guidance should include examples of what is good and what is inadequate. The FRC Lab is excellent at providing such examples in all its work.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal con

60. Again, providing examples of good and bad definitions would be helpful.
61. All organisations have their own risk language so need help less with terminology and more on how to present them in ways stakeholders will understand that matches what the company intended.
62. It is important for boards to understand the nuances of threats, vulnerabilities, risks and controls and how these are interlinked. This provides the basis for assessing how risk appetite and tolerances work. Only then can boards ascertain how the overall risk management and control practices within the organisation contribute to a continuously functioning business.
63. We are concerned that boards do not understand risk and control management. Effective risk management is multidimensional, and requires understanding the causes of risk to understand the impact one or multiple control failures will

have, and whether containment and severity is isolated or systemic for the organisation. This means continuous assessment holistically across the organisation, on a region-by-region basis, On a department-by-department basis and on a function-by-function basis.

64. Thus: an effective risk management and internal control system is one that can always implement and adjust controls based on risk appetite and tolerances across all aspects of the organisation; a material weakness is anything that causes a negative impact above a predefined threshold, assessed on risk appetite and tolerances as set by the board, to the business's products and services, the operations, the stakeholders, the finances and the reputation.

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

65. Yes.
66. In the absence of technology-rated principles in the Code, include IT, data and cyber specific guidance for the foundations businesses can use when preparing for AI.
67. How to identify risk appetite and tolerance across material aspects of operations, e.g. cybersecurity. These are good indicators about how robust the controls need to be.

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)?

68. Yes.
69. The Government's proposals want resilience statements, the AAP, distributions and fraud to be for 750/750 PIEs but we would want them for all PIEs and all Code companies.
70. Assuming alignment, we are unsure what the FRC's reporting expectations of non-PIE Code Companies: will a statement suffice that says the company does not comply because legally it has no requirement to do so? Will non-PIE Code Companies be able to partially comply with chooses elements of, for example, the Resilience Statement and Audit and Assurance Policy or will it be an 'all or nothing' approach?

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

71. Yes.

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?

72. Yes.

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

73. Retail shareholders specifically have a number of comments as follows, which we believe will help all stakeholders:
74. Logic suggests that the first principle should be that the remuneration policy is linked to the company strategy.
75. The differences between remuneration policies, practices and outcomes requires more clarification.
76. It is unnecessary to make specific mention of “environmental, social and governance objectives” in the proposed Principle P.
77. The Companies Act 2006 requires certain disclosure of remuneration. The Code should refer to these, why it thinks additional disclosures are necessary and hence why they should be best practice.
78. There is no reference to the Quoted Companies Alliance’s Guide for Corporate Governance or the GCA’s Remuneration Guide. We think both of these are more appropriate than the Code for smaller quoted and AIM companies. Please include reference to these alternative Codes/Guides.
79. We suggest that the Principles O, P and Q should be redrafted as follows:
80. *O. Remuneration policies and practices should be designed to support the company strategy. Remuneration practices should be clearly aligned to company performance, purpose and values, and the successful delivery of the company’s long-term strategy.*

P. The remuneration committee should exercise independent judgement and discretion when authorising remuneration outcomes, taking into account of company and individual performance, and wider circumstances.

Q. A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome.

81. We believe the contents of old Provision 40 and 41 are still relevant today and definitely into the longer term, when remuneration takes into account remuneration against the complexities of ESG and AI. Our concern is that with more flexibility, the greater the chance of pay-washing.
82. See also our response to Q24.

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

83. No. Disclosure should be for 10 years, not 5. Malus and clawback are long term issues.
84. Proposed Provision 39, first sentence, talks of use of discretion, but how can this operate if the company has to specify the circumstances as per the last sentence? As drafted, we expect very few companies will exercise discretion and any malus and clawback will be limited to gross misconduct and restatement of accounts.
85. Retail Investors want something more tangible, such as obtaining pay clawed back when the share price goes down, e.g. halves, quarters or drops by 90%.
86. Can the FRC confirm that information in side letters now needs to be disclosed, or should be disclosed as best practice? Historically side letters have been used to contain information not in the employment contract. For example, side letter terms apply when the circumstances described in the side letter crystallise for example Frank Goodwin's very large RBS pension. The side letter we believe, said that he would get 40 years' service regardless of actual service.

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

87. No. We are sorry to see the original Provision 40 deleted with the loss of the words 'clarity', 'simplicity', 'risk', 'predictability', 'proportionality' and 'alignment' and the definition of what the FRC means by these words in this context. The changes to para 40 are a retrograde step.

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

88. 'Pay gaps' is a bit of jargon and should be removed. The paragraph needs to reflect the pay legislative requirements to disclose pay ratio data (CEO to median, quartiles and averages of employees) and gender and ethnicity data.
89. The ratio of the CEO pay to his/her #2 and the average of the top 10 (and for FTSE100 companies the top 100 and top 1,000) executives should be disclosed as best practice together with a commentary on succession planning. This should be part of the Code's Section 3, Provisions 18 - 24.
90. From the 'S' perspective within ESG, pay ratios should be strengthened and explicitly support the requirements in the Equality Act.

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?

91. We agree with the Government's five cross-sector principles but these are at such a high level, it is impossible for a non-expert to apply them in a suitable way.
92. AI requires an equivalent amount of scrutiny as the financials have always had and, more recently, ESG is having.
93. But UK plc is missing the basics to manage AI's considerable opportunities and risks because we have not paid attention to the governance and materiality of technology. Businesses (via robotics, security tools, Internet of Things) and consumers (via Siri, Alexa, smart homes) are using AI now without consciously knowing they are doing so. Technology, data and cybersecurity are the bedrock for organisational success but are not mentioned in the Code. As a result, we do not believe the Government's approach to AI regulation can be applied in any meaningful way.
94. The Code needs, as a minimum, a section on technology and information. South Africa's King IV Code includes in its Principle 12: "The governing body should govern technology and information in a way that supports the organisation setting and achieving its strategic objectives." Only when we have the UK equivalent established in our Code, can we work out how to apply the Government's principles for AI.
95. To provide a safe, robust and exciting AI environment, we would like to see the regulators come together on the use of AI to encourage opportunity whilst protecting consumers and business interests. We are aware of a number of initiatives from the main UK regulators and would like them to work not only together but also with business and consumer groups to identify how the five principles will be applied in society.

96. Relevant links:

ICO: [Artificial intelligence | ICO](#)

FRC: [News | Financial Reporting Council \(frc.org.uk\)](#)

CMA [CMA launches initial review of artificial intelligence models - GOV.UK \(www.gov.uk\)](#)

Bank of England/FCA: [AI in Financial Services: Bank of England and UK FCA Highlight Key Challenges and Risks – Tech & Sourcing @ Morgan Lewis](#)