CHANGES TO THE UK CORPORATE GOVERNANCE CODE

THE NEW UK CORPORATE GOVERNANCE CODE

On 16 July 2018, the Financial Reporting Council ("**FRC**") published a revised UK Corporate Governance Code (the "**Code**"). The Code is aimed at promoting successful and sustainable businesses and encouraging long-term investment. However, the Code is not rigid in its application and does not provide set rules, but allows companies to adopt a flexible approach through the use of principles set out in the Code and the "comply and explain" method of reporting. Accordingly, Companies are encouraged to promote integrity and openness, value diversity and to be responsive to the views of shareholders and wider stakeholders.

The Code is supported by the simultaneous publication of the FRC's Guidance on Board Effectiveness (the "**Guide**"). The Guide has been published in order to assist company boards with self-reflection on the role of the board and its effectiveness. The Guide also sets out suggested good practice in relation to how a board operates. This suggested good practice assists boards in developing their own good practice and provides stakeholders with a reference point against which actions taken by a board can be assessed.

Externally managed investment companies may find certain principles of the Code not relevant and a more appropriate alternative to the Code, the Association of Investment Companies' Corporate Governance Code, may be used to meet their obligations under the Code. The AIC will be considering what adjustments need to be made to its Code to retain the FRC's endorsement and will be consulting with its members in due course.

The Code has been curtailed to facilitate the easy adoption of the principles of the Code. These principles are set out in five concise categories:

1. Board Leadership and Company Purpose;
2. Division of Responsibilities;
3. Composition, Succession and Evaluation;
4. Audit, Risk and Internal Control; and
5. Remuneration.

The reforms in the Code that are particularly relevant to Investment Companies and will be effective from 1 January 2019 include:

Stakeholder engagement – (Provision 5 of the Code) companies will be required to enhance engagement with stakeholders to ensure that policies and practices are in line with the company's values to support long-term sustainable success and to explain in the annual report how stakeholder interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making.

Shareholder opposition (Provision 4) – Should any resolution proposed by the board receive shareholder opposition of more than 20%, then the company is to explain what actions it intends to take to open a dialog with the shareholders to understand the shareholder's views and reasons for the opposition. Then, within 6 months of the vote, the board is required to publish an update on the actions taken and feedback received from shareholders. The annual report should include a final summary of the impact of the shareholder's feedback on the board's decisions and any consequential actions or resolutions. It is anticipated that the Investment Association, in a related initiative, will maintain a public register of such votes.

Chair's Position and independence (Provision 19) – The Code retains the provision that the Chair should be independent on appointment. Subsequently the Chair is not counted in the assessment of board independence. Most significantly, the FRC has adopted provisions which presume a limit on the tenure of the Chair. We understand that the limit on tenure applies to the entire period of the Chair's service on the board. It is not limited to the period that a director serves as the Chair. This period can be extended if an explanation is provided, but is a significant departure form the FRC's previous position.

Non Executive Independence (Provision 10) – In addition to requiring an appropriate combination skills, experience and expertise, length of service is a key consideration under the Code. If a non executive director does not meet the independence criteria, they should not be considered independent, for example, individuals serving for over 9 years will no longer be considered independent.

Annual Re-election (Provision 18) - All directors should be subject to annual re-election. This changes the current position where annual re-election is only expected for companies in the FTSE350.

Board Evaluation (Provision 21) – The Code expects regular formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should consider having a regular externally facilitated board evaluation. It specifies that this "should happen" every three years for FTSE 350 companies.

Diversity (Provision 23) – A new principle in the Code requires the board to consider board appointments and succession plans. Particular attention should be paid to promoting diversity in the membership of the board. While the Code does not set out specific diversity criteria, it encourages boards to consider other aspects of diversity in addition to gender. The annual report should describe the work of the nomination committee including "the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives".

Nomination Committees (Provision 17) - The Code does not specify the number of independent directors required for the nomination committee. Under the Code, Nomination Committees are responsible for the composition, succession and evaluation of the board and oversee the development of a diverse pipeline for succession.

Audit Committees (Provision 24) – The FRC has retained the capacity of companies outside the FTSE350 to have an audit committee comprising two individuals. However, the Chair should not be a member of the audit committee.

Remuneration Committees – The Code clarifies that the Remuneration Committee and not the board is responsible for exercising discretion over remuneration outcomes. This effectively, widens of the scope of the Remuneration Committees' responsibilities to oversee the company's remuneration policies and objectives. Further, the Code now requires that remuneration committee chairs should have served for at least 12 months on a remuneration committee before their appointment.

Smaller Companies – All exemptions from Code requirements for companies below the FTSE 350 will be removed going forward. Smaller companies will now need to, inter alia, assess board composition, conduct board evaluation, hold annual board re-elections and review audit and remuneration committee composition.

WHAT ACTIONS TO TAKE?

Under the Code, companies will be expected to enhance their reporting on corporate governance and on the implementation of the principles of the Code. Further, additional disclosures will be expected in annual reports published after 1 January 2019.

Companies should now be reviewing their existing stakeholder engagements. The Code requires companies to maintain open and continuous dialog with shareholders and all stakeholders and to align their decisions and practices to best promote the interests of all parties that may be affected by the decisions of the board.

Companies should also be careful when constituting boards and key board committees. Consideration should be given to issues like whether or not the remuneration committee chair would have sufficient previous experience on a remuneration committee and if non executives and chairs would meet revised independence requirements. Importantly, companies should be actively pursuing all aspects of diversity when considering board appointments.

Smaller companies, below the FTSE 350, will be expected to elevate their corporate governance to bring it more in line with the Code and the principles of good practice. Specifically, smaller companies should be reviewing their arrangements in relation to board and committee composition, re-election of directors and board evaluation.

Adherence to good standards of compliance and corporate governance standards is an aspiration that any organisation should strive towards.

If you would like to explore how these changes will affect your business and how you can prepare please contact Susan Fadil to set up a consultation.

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