UK Corporate Governance and Stewardship

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FRC Financial Reporting Council

The FRC: Who we are and what we do

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Regulatory Framework

- The FRC is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.
- We encourage trustworthy behaviour by directors and professionals and engagement by investors
- We encourage companies to produce trusted information that contributes to informed decisions

Our teams

FRC Codes and Standards Team

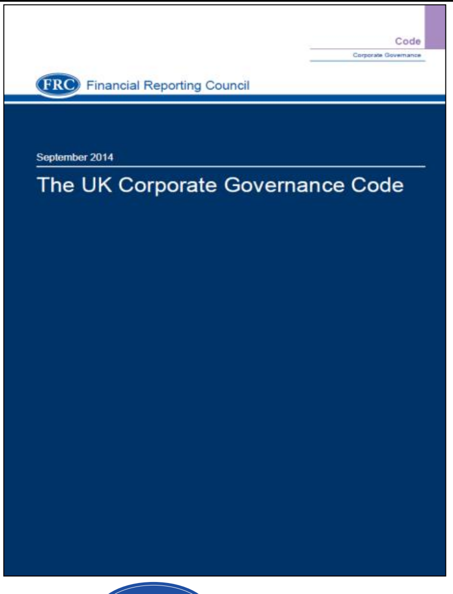
- Accounting and Reporting Policy
- Actuarial Policy
- Audit and Assurance
- Corporate Governance
- Financial Reporting Lab

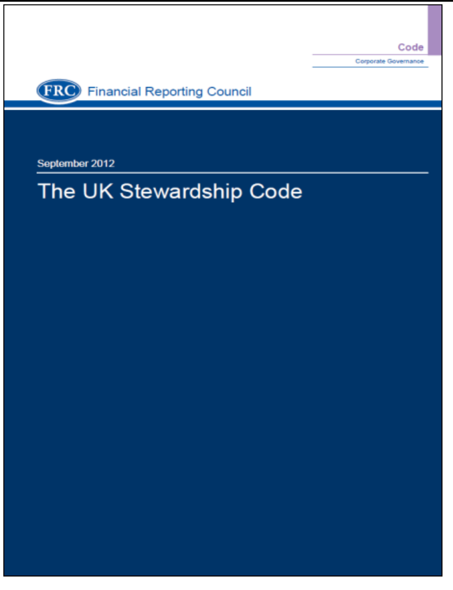
FRC Conduct Team

- Audit Quality Review
- Corporate Reporting Review
- Professional Discipline
- Professional Oversight

How we develop codes and standards

- We encourage those we regulate and the investor community to engage with us (consultations)
- We try to avoid imposing disproportionate burdens on market participants
- We favour principles over prescription (comply or explain)
- We try to be innovative in our approach (Financial Reporting Lab)





UK Corporate Governance

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The UK regulatory framework for corporate governance

- **Company and Securities Law (Government)**
  - Directors' duties
  - Shareholder rights (e.g. voting, pre-emption rights)
  - Reporting requirements (e.g. Directors' remuneration)
- **Listing Rules and equivalent rules for investors (FCA)**
  - Set voting and reporting requirements, include requirements to report on how the Codes are applied
- **'Comply or Explain' Codes (FRC)**
  - The UK Corporate Governance Code (for listed companies)
  - The UK Stewardship Code (for fund managers and owners)

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History of the CG Code

- **Late 1980s to early 1990s: Corporate collapses and scandals**
  - the UK business community recognised the need to improve governance
- **1992: Cadbury Report**
  - a committee chaired by Sir Adrian Cadbury issued a series of governance recommendations including the need to separate the roles of the CEO and Chairman, and the creation of audit committees
- **1992: Comply or explain**
  - the listing rules required companies to report if they had followed the recommendations of the Cadbury report and if not, to explain why
- **1995: Greenbury Report**
  - the Greenbury Report sets out recommendations on the remuneration of directors: the creation of remuneration committees of independent non-executive directors and disclosure of a remuneration report

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- **1998: Hampel Report**
  - The Cadbury and Greenbury Reports were brought together under one report entitled **Combined Code on Corporate Governance**
- **1999: Turnbull Committee**
  - established to provide guidance on the internal control requirements of the Combined Code, including guidance on risk management
- **2003: The Higgs Review**
  - examined the role and effectiveness of non-executive directors. The Smith Report was published around this time focusing on the role of audit committees. In 2003 the FRC took responsibility for publishing and updating the code to include Higgs' and Smith's recommendations
- **2010: The UK Corporate Governance Code**
  - following limited revisions in 2006 and 2008, the Combined Code was renamed the UK Corporate Governance Code. Changes included the introduction of annual elections for directors of FTSE 350 companies

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- **2012: Main updates to the Code**
  - FTSE 350 companies required to put their external audit contract out to tender at least every three years.
  - More information required in Audit Committee reports.
  - Companies to explain, and report on progress with their policies on boardroom diversity.

- **2014: Updated Code**

  Updates promoted a longer term approach to corporate governance:
  - risk management and going concern
    - boards should look at least a year ahead in making their going concern judgement for accounting purposes
  - New longer term viability statement
    - Companies should give a longer term viability statement, taking account of their current position and principal risks, qualifications and assumptions, specify the period covered by this statement and why they consider it appropriate on he basis of a reasonable expectation
  - Changes to reporting on remuneration
    - promoting link between remuneration and sustained success of the business

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Scope of the UK Corporate Governance Code

- Applies to premium listed companies
- Five sections covering:
  - Board leadership and composition
  - Board effectiveness
  - Reporting and risk management
  - Remuneration
  - Relations with shareholders
- Principles – company must explain how they apply
- Provisions – companies must comply, or explain if they do not
- Additional guidance, e.g. on audit committees, risk management

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‘Comply or Explain’

Regulators set standards and require reporting; shareholders enforce

- **Rationale**
  - Intended to raise best practice above legal requirements
  - Shareholders (not regulators) decide whether the board is acting in their interest
- **Successes**
  - High rates of compliance (2015: 94 per cent of companies complied with all, or all but one or two, of provisions, while 61 per cent reported full compliance with the Code.)
  - Rapid uptake of good practice
  - Specific successes: split of chairman and CEO roles; majority of independent directors; audit committees; board evaluation
- **International take-up**
  - The European Commission issued a Recommendation on the quality of corporate governance reporting, based on the ‘comply or explain’ principle in April 2014.

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How do we monitor the CG Code?

- Research into compliance data from FTSE 350 and small cap companies
- Analyse trends and the application of recent Code changes
- Sample review of explanations of non-Code compliance
- Meetings with Chairmen and Senior Investors to gain informed opinion on current issues

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Monitoring – recent findings

- Overall levels of compliance with the UK Corporate Governance Code continue to improve with full compliance by the FTSE 350 now at 61% and 94% complying with all but 1 or 2 provisions.
- There have been improvements in audit committee reports, with good examples of greater transparency and informative reporting.
- There has been very good progress on reporting on diversity policies in the FTSE 100 – 85% now have a clear policy – but the FTSE 250, while improving from 20% to 56%, have more to do.
- The UK has met Lord Davies target of 25% FTSE 100 female directors in 2015, with 26.1% of directorships now held by women.
- Improving the executive pipeline in connection with the wider diversity issue remains a priority.

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Priorities 2015/16

- Assessing quality of **board succession** planning and considering how to develop best practice (discussion paper October 2015)
- Review how boards establish **company culture** and practices, embedding good **corporate behaviour**
- **Review uptake** of 2014 updates on going concern and remuneration
- Minor changes to the Code (Audit) implementing the EU Audit Regulation and Directive

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International interaction

- Engage with overseas regulators to share policy and best practice.
- Collaboration with the European Union on corporate governance matters as virtually all Member States now have a corporate governance code.
- The UK chairs the **European Corporate Governance Codes Network** - an informal network that exists primarily to share views, experiences and good practice on issues relating to the corporate governance of listed companies.
- The Network shares factual information on the content and implementation of national corporate governance codes with European authorities and other interested parties.

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UK Stewardship

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UK Stewardship Code

- The UK Stewardship Code sets out the principles of effective stewardship by investors
- The Code has seven principles:
  - Public disclosure of stewardship approach
  - Conflicts of interest
  - Monitoring of investee companies
  - Escalation/ engagement
  - Collective engagement
  - Voting
  - Reporting to clients/ beneficiaries

Aims of disclosure

Disclosures made in relation to the Code should:

- assist **companies** to understand the approach and expectations of their major shareholders
- assist **those issuing mandates** to asset managers to make a better informed choice
- **assist fund managers** to understand the expectations of currents and potential clients
- help **investors** interested in collective engagement to identify like-minded institutions

Stewardship Code reporting

- UK-authorised Asset Managers are required under the FCA's Conduct of Business Rules to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model
- Institutional investors are encouraged to publish a statement on their website of the extent to which they have complied with the Code, and to notify the FRC when they have done so and whenever the statement is updated
- Responsibility for monitoring company performance does not rest with fund managers alone.
- Pension fund trustees and other asset-owners can do so either directly or indirectly through the mandates given to fund managers.

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How do we monitor the Stewardship Code?

- The FRC monitors a sample of signatories' statements against the Code every year.
- The 2014 monitoring sample covered 50 signatories chosen at random across all three categories – asset manager, asset owner and service provider.
- The main concern remains the quality of reporting against the seven principles of the Code.
- One of the main objectives of the Code is to build transparency of approach through the investment chain, which can only be achieved through sufficient and effective reporting to clients and beneficiaries.

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Monitoring – recent findings

- The UK Stewardship Code has 303 signatories to the Code - 207 asset managers, 83 asset owners and 13 service providers
- Despite increases in the quantity and quality of engagement, not all are following through on their stewardship responsibilities.
- There are some signs of improvement, with mandates increasingly referring to stewardship and reports of better proactive engagement by companies and investors over the 2014 AGM season.
- The FRC is concerned that signatories are not reporting effectively across the seven principles of the Code, with appropriate explanations and are not keeping statements up to date. Disclosures on conflicts of interest also continue to be of concern.
- Concerns from companies and investors about the role of proxy advisors, particularly in terms of a perceived lack of engagement with companies and a “box-ticking approach”.

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Priorities 2015/16

- **Looking at adherence to the Stewardship Code**
  - The FRC requires signatories to make statements against the Stewardship Code, but some of these statements are not of sufficient quality. The FRC is analysing signatory statements and is looking to distinguish between good and insufficient quality of reporting .
- **Influencing the development of the new EU Shareholder Rights Directive**
  - The revised Shareholder Rights Directive will require institutional investors in all EU member states to publish an 'engagement policy' (akin to a Stewardship Code). The FRC is working with the UK Department for Business, Innovation and Skills and European counterparts to promote the use of 'comply or explain' in the Directive.

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Corporate culture

- “culture coalition”
- People/employees
- Stakeholders
- Embedding and assurance
- Report, guidance and observations

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Audit Committee

- Establishment
- Composition
- Responsibilities
- Accountability
- Guidance

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Audit Committee

- **No changes** to current Code **where consistent** with the ARD
- **Establishment**: Company Law, Disclosure and Transparency Rules (7.1) and Code - no change
- **Composition**:
  - that at least one member has competence in accounting and/or auditing from previous wording, which required at least one member to have recent and relevant financial experience
  - Audit Committee as a whole to have competence relevant to the sector in which the company operates
- **Responsibilities**: Article 39 and Code C.3.2 equivalence
- **Accountability:Removal of audit tendering provision** (C.3.7) and whether an advisory vote on the AC report is required (CMA recommendation)

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