A "SHORTER, SHARPER" UK CORPORATE GOVERNANCE CODE

On 16 July 2018, the FRC published an updated version of the UK Corporate Governance Code (Code), which will apply to financial years starting on or after 1 January 2019. Alongside it, the FRC also published its updated Guidance on Board Effectiveness (Guidance) which contains suggestions of good practice to support directors and their advisers in applying the Code. All companies with a premium listing (whether UK incorporated or not) are required to report annually, on a "comply or explain" basis, against the Code.

In the FRC's words, the new Code is intended to broaden "the definition of governance and emphasises the importance of:

- Positive relationships between companies, shareholders and stakeholders.
- A clear purpose and strategy aligned with healthy corporate culture.
- High quality board composition and a focus on diversity.
- Remuneration which is proportionate and supports long-term success."

The new Code is much shorter than the current 2016 version of the Code (2016 Code) - about half its length - and focuses most particularly on the application of the principles, with fewer supporting provisions. It is divided into five sections: board leadership and company purpose; division of responsibilities; composition, succession and evaluation; audit, risk and internal control; and remuneration. The FRC has published a supporting document entitled "Key highlights of the Code" which provides a broad overview of the new Code. In this briefing, we consider those provisions which we believe will be of greatest interest to companies and their boards.

Board leadership and company purpose

- There is a clearer statement of the board's responsibility to establish the company's purpose, value and strategy and to ensure that these are aligned with the company's culture. The board should ensure that workforce policies and practices are consistent with these values (Code principles A and E.) These principles are reinforced by provisions which place an onus on the board to assess and monitor culture and to hold management to account where the board is not satisfied that policy and practice aligns with the company's values and strategy (Code provision 2).
- Where 20% or more of votes have been cast against a resolution, the company should explain, when announcing the voting results, what actions

Key issues

- New Corporate Governance Code to apply to financial years starting on or after 1 January 2019.
- New Code emphasises the importance of aligning the company's strategy and purpose with its corporate culture and ensuring a high quality and diverse board composition.
- Enhanced focus on stakeholder engagement, in particular, a company's mechanisms for meaningful engagement with its workforce.
- New Code sits alongside new narrative reporting requirements which require directors to describe, in a "s.172 statement", in the strategic report how they have had regard to the duties set out in s172(1) of the Companies Act 2006 during the course of the financial year.
- FRC recommends companies should report against Code Provision 4 (reporting requirements which apply where 20% or more of votes have been cast against a resolution) in relation to any shareholder votes taken after 1 January 2019.

it intends to take to consult shareholders in order to understand the reason behind those votes. In addition, an update on the views received and actions taken should be published no later than six months after the shareholder meeting. The board should include a final summary in the next annual report, or in the explanatory notes to the resolution at the next shareholder meeting, of what impact the feedback has had on decision making and any actions or resolutions now proposed (Code provision 4). The FRC recommends that companies should start to report against this provision in relation to any shareholder votes taken after 1 January 2019.

- As expected, the Code includes provisions requiring the board to understand the views of the company's other key stakeholders and to describe in the annual report how their interests and the other matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making (Code provision 5). This provision is intended to support the requirement to report on the same matters (which is set out in The Companies (Miscellaneous Reporting) Regulations 2018 – see separate briefing linked to below).
- The Code recommends that a company engages with its workforce using one or more of three methods: a director appointed from the workforce; a formal workplace advisory panel; or a designated non-executive director.
- However, the Code also recognises that a "one size fits all" approach is not appropriate, and it permits a board the flexibility to use alternative methods so long as it explains what these are and why it considers that they are effective (Code provision 5). The Guidance includes examples of other workforce engagement activities that companies may wish to adopt (such as consultative groups, social media updates, employee AGMs and surveys). The Code deliberately uses the term "workforce" rather than "employees" and recommends that boards consider engaging not just with those employees with a formal contract of employment (permanent, fixed-term or zero hours), but also with agency workers and remote workers. The practical challenge will be in ensuring workforce and other stakeholder engagement is meaningful and, crucially, that boards reflect on and, where appropriate, respond to the outcomes.
- Companies should ensure that processes are in place to enable the workforce to raise concerns in confidence and – if they wish – anonymously. The board should ensure arrangements are in place for proportionate and independent investigation of such matters and for follow-up action (Code provision 6).

Division of responsibilities

- The draft Code that the FRC issued for consultation in December 2017 (draft Code) included a number of changes to the provisions in the current 2016 Code regarding the composition of the board. In particular, the draft Code recommended that (i) the chair should be independent on an ongoing basis (as opposed to independent on appointment as per the 2016 Code) and (ii) that independent non-executive directors (INEDs), including the chair, should constitute the majority of the board (in contrast to the 2016 Code which excludes the chair from this calculation and which only requires at least half of the members of the board to be INEDS).
- In the new Code, the FRC has reverted to the position under the 2016 Code, meaning the chair need only be independent on appointment (Code

Section 172 Companies Act 2006 Duty to promote the success of the company

1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —
   a) the likely consequences of any decision in the long term,
   b) the interests of the company's employees,
   c) the need to foster the company's business relationships with suppliers, customers and others,
   d) the impact of the company's operations on the community and the environment,
   e) the desirability of the company maintaining a reputation for high standards of business conduct, and
   f) the need to act fairly as between members of the company.

provision 9) and requiring at least half the board, excluding the chair, to be INEDS (Code provision 11).

- In the draft Code the FRC proposed to remove the "presumption of independence" of a director set out in provision B.1.1 of the 2016 Code. Under the 2016 Code, whilst the existence of certain factors may indicate that a director is not independent, ultimately it is for the board to determine whether a director is independent or not. Helpfully, the FRC has decided in the new Code to maintain the position under the 2016 Code, meaning that the board retains responsibility for determining director independence (Code provision 10).
- The Code has a greater focus on "overboarding" – ensuring that directors do not take on too many directorships, leaving them with insufficient time to dedicate to their role. In particular, prior to a director's appointment, all significant commitments should be disclosed to the board and no additional external appointment should be undertaken without the prior approval of the board (Code provision 15). In line with the 2016 Code, full time executives should not take on more than one non-executive directorship in a FTSE100 company or other significant commitment. The issue of overboarding is one which is increasing becoming an area of focus for investors and boards may wish to consider undertaking an internal "audit" of existing director commitments to satisfy themselves that all board members have sufficient time to dedicate to their respective roles.

Composition, succession and evaluation

- Whilst the new Code recommends that the chair should not remain in post beyond nine years from the date of his or her first appointment, it expressly acknowledges that where it is necessary to facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time (particularly in cases where the chair was an existing non-executive director on appointment). A clear explanation should be provided where this is the case (Code provision 19).
- Building on the work of the Hampton-Alexander and Parker reviews on gender and ethnic diversity respectively and recognising the benefits that diversity on boards brings to good decision-making, Code principle J recommends that appointments and succession planning should, whilst based on objective and merit-based criteria, promote diversity of gender, social and ethnic backgrounds. There are additional reporting requirements too - the annual report should include information on the company's policy on diversity and inclusion and how this links to company strategy, along with information on its implementation and progress on achieving its objectives (Code provision 23). These requirements reinforce the requirements of DTR 7.2.8A on diversity reporting in a company's corporate governance statement.

Remuneration

- Acknowledging the importance of the role of the remuneration committee chair, the Code requires that, before appointment, the chair of the remuneration committee should have served on a remuneration committee for at least 12 months (Code provision 32).
- The Code recommends that the remuneration committee should review workforce remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting

the policy for executive remuneration (Code provision 33). There is also a new requirement that the board should include in the annual report an explanation of the company's approach to investing in and rewarding its workforce (Code provision 2).

- There is a new provision requiring that shares awards be subject to a total vesting and holding period of five years or more (in contrast to three years under the 2016 Code) (Code provision 36).

Stewardship Code

As part of its consultation on the Code, the FRC sought some initial views on the future of the UK Stewardship Code, which was last reviewed in 2012. The majority of respondents agreed it would be helpful to have clearer expectations of the stewardship roles and responsibilities of those at different points of the investment chain. There was also a desire for greater attention to be given to the role of proxy advisers.

The FRC intends to publish a draft of the Stewardship Code for consultation in late Autumn 2018, with a view to publishing the final version in Spring 2019.

Further information

For further information about how the new Corporate Governance Code may affect your business, please contact either your usual Clifford Chance contact or any of the authors of this briefing.

To access a copy of the new Code and the supporting Guidance, along with the feedback statement on the draft Code consultation, go to: https://www.frc.org.uk/news/july-2018/a-uk-corporate-governance-code-that-is-fit-for-the

For a copy of our briefing on The Companies (Miscellaneous Reporting) Regulations 2018, go to: https://www.cliffordchance.com/briefings/2018/06/government_publishesnewnarrativereportin.html

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