David Styles
Director, Corporate Governance and Stewardship
Financial Reporting Council

By email: codereview@frc.org.uk

31st August 2023

Dear Mr. Styles,

ICGN Response to the UK Corporate Governance Code Consultation Document

The International Corporate Governance Network (ICGN) appreciates the opportunity to comment on the UK Corporate Governance Code Consultation Document, published by the Financial Reporting Council (FRC).

Led by investors responsible for assets under management of $77 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship contributing to long-term corporate value, sustainable economies, and wider society. Headquartered in London, our membership is based in more than 40 countries, largely in Europe and North America, with growing representation in Asia. For more information visit www.icgn.org.

Our commentary is largely based on the ICGN Global Governance Principles[1], which are widely used by ICGN Members in their company assessments and voting decisions. The ICGN Principles are also often referred to by regulators and standard setters in the development of national and international corporate governance policies. Most recently the ICGN Principles, alongside the G20-OECD Corporate Governance Principles, were cited in the EU Corporate Sustainability Directive as an authoritative global framework of governance information of most relevance to users.

We applaud the leadership of the FRC in the development of the UK's Corporate Governance Code over many decades. The UK Code is highly regarded internationally and often referred to as a bellwether for the highest standards of corporate governance and emulated by other markets as part of ongoing reform efforts. Periodic revisions to the UK Code is therefore highly likely to influence corporate governance practices around the world and is thus an important document for ICGN Members, not only in the UK but globally.

Section 1: Board, leadership, and company purpose

1. Outcomes based reporting

We welcome greater emphasis for the board to understand the views of shareholders and to report on outcomes of engagement as specified in Provision 3 and Principle D. This will coordinate efficiently with the outcomes-based reporting expectations for investors under the UK Stewardship Code. We encourage more clarity regarding the meaning of the word 'outcomes.'

We welcome increased emphasis on the importance of companies providing clear explanations for any deviations to code provisions according to their individual circumstances. Explanations from companies for the deviations should be meaningful and

[1] ICGN Global Governance Principles | ICGN (2021)

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provide investors with a clear reason for the alternative approach and the impact and outcomes that this may have.

More generally, we are unclear as to whether the reference to the increased number of companies not fully complying with the code (as described in paragraph 8) is a positive development but recognize that this does infer that more companies are opting to explain an alternative approach which can help improve the quality of disclosure by providing information around any challenges that a company may be experiencing.

2. Climate related reporting

We agree with the new reference in Provision 1 for the board to describe in the annual report how environmental and social matters are considered in the delivery of its strategy including its climate ambitions and transition planning.

However, we caution deleting reference to the need for the annual review to include how 'governance' contributes strategy delivery. We believe that high standards of corporate governance are essential for successfully managing sustainability related risks and opportunities. We also encourage consistency by regulators around what constitutes 'governance' reporting, noting discrepancies for example between the EU Corporate Sustainability Reporting Directive and the Sustainable Finance Disclosure Regulations.

ICGN's own position regarding climate ambitions and transition planning are clarified in the ICGN Statement on Share Climate Responsibilities[2], whereby we call on companies to:

- Ensure robust governance procedures and board competence in overseeing how management identifies, monitors, measures and manages climate change risks and opportunities aligned with company purpose and long-term strategy.

- Publicly commit to science-based targets (including ambitious but credible interim targets) on how the business will adapt to net zero carbon emissions by 2050.

- Develop and publish transition plans which include assessments of physical, transition and liability risks and opportunities based on climate change scenario analysis.

- Ensure the authenticity of disclosure and communicate progress towards meeting targets and just transition plans through annual reports and other appropriate communications.

- Assess biodiversity-related dependencies and impacts, with a view to meeting the disclosure requirements specified in the Taskforce on Nature-Related Financial Disclosure.[3]

- Align CEO and senior executive pay with the company's purpose, strategy and workforce, using sustainability-related performance metrics, particularly those associated with the company's just transition plan and how long-term value is created by integrating these elements into business operations.[4]

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[2] ICGN Statement of Shared Climate Change Responsibilities in Response to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 23 March 2023.

[3] Taskforce on Nature-related Financial Disclosures and their Risk & Opportunity Management and Disclosure Framework

[4] See ICGN Global Governance Principles (2021), Principle 5: Remuneration

3. Other comments

Shareholder engagement

We recommend that this principle be strengthened with new language clarifying board responsibility for ensuring that annual general meetings (AGMs) are managed efficiently, democratically, and securely, to properly facilitate constructive engagement with shareholders. We emphasize that such matters should include governance, sustainability related risks and opportunities and management's performance in pursuing the company's long-term strategic objectives.

More generally, we observe significant disruption to AGMs this year with more companies holding meetings in a fully virtual format, or for an increasing number of directors to appear virtually, rather than physically. This is a concern for ICGN Members given a fully virtual format can inhibit the ability of shareholders to ask questions, vote and make statements from the floor. Having said that, we also recognize that there are benefits to virtual meetings, particularly in terms of enabling increased shareholder participation without a requirement for travel. In this regard, the board should ensure that meeting participants are fully informed of the meeting procedures, the participation rights are upheld and that shareholders are generally able to meaningfully interact with the board and management. we refer you to Principle 10 of the ICGN Global Governance Principles which sets our expectation around the management of shareholder meetings.

Section 2: Division of responsibilities

4. External commitments and board evaluation

We welcome reference to a directors' commitment to other organizations being considered as part of the annual evaluation under principle K. We would strengthen this further by stating that individual director re-election should be contingent on a satisfactory valuation of their contribution to the board.

We also note the use of a skills matrix in many markets to align the criteria for board appointments more directly with company purpose and long-term strategy and this could be also helpful in the UK. The skills matrix could include: a) functional skills, b) industry experience, and c) leadership and administrative experience. Moreover, we would recommend ensuring that board evaluations assess collective 'soft' skills, such as the functioning of the board as an effective discussion and decision-making team, in addition to individual skills of each director.

5. Transparency around commitments

We welcome strengthened language around multiple director appointments in Provision 15 and the expectation that directors commit sufficient time to undertake their responsibilities effectively.

Disclosure should include information about the number and nature of directorships, including any commitments relating to non-profit organizations, such as charities. We suggest clarification of the meaning 'significant' in relation to director appointments in the annual report.

Section 3: Composition succession and evaluation

6-8. Diversity and inclusion

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We appreciate the broader reference to 'diversity and inclusion' on corporate boards to increase the capacity for board discussion and thus the quality of board decisions. However, we caution removal of specific reference to 'gender', notwithstanding reference to gender balance is made under Principle 24 with regards to senior management. While we acknowledge the UK's achievement this year of reaching 40% of women on corporate boards in FTSE 350 companies, we would like to ensure continued progress. As noted in our introduction, the UK Corporate Governance code is recognized as a world leader and many markets are still lacking in terms of gender diversity on corporate boards. We therefore encourage the UK to maintain a specific reference to gender in the UK Corporate Governance Code.

We appreciate the new reference to equal opportunity and diversity under Provision I in the drafting related to board composition. However, we suggest simplification of reference to 'protected characteristics and non-protected characteristics.' It may be more succinct to refer simply to 'characteristics' noting a footnote to explain how this is 'protected' under UK law.

9. Board evaluation

We support the adoption of recommendations provided by the Chartered Governance Institute around the effectiveness of independent board evaluation in the UK listed sector.

We appreciate strengthened language for an external board performance review to be commissioned and conducted once every three years under Provision 24. The board should disclose the process for the review and, as far as reasonably possible, any material issues arising from the conclusions and actions taken as a result. In addition to the identity of the external reviewer, the terms of reference, along with fees, should also be disclosed.

Section 4: Audit, risk, and internal control

10. Audit and Assurance Policy

ICGN agrees that all Code companies should prepare an Audit & Assurance Policy (AAP) on a comply or explain basis, which extends to providing information on the rationale for the type of audit and assurance services adopted. We welcome publication and review of the policy every three years, complemented by an annual implementation report. We also agree that the Audit Committee should be responsible for developing the AAP and monitoring its implementation.

We agree that more engagement between audit committee members and shareholders could be encouraged. ICGN's Financial Capital Committee, together with the ICGN Secretariat, leads ICGN's own policy engagements related to corporate reporting, auditing, and assurance.

With the rapid development of corporate sustainability reporting standards, an AAP and annual reporting will help to instill confidence with investors and stakeholders around the reliability of corporate reporting, upon which investment and voting decisions are made. ICGN therefore welcomes commensurate standards on assurance, such as the IAASB's International Standard on Sustainability (ISSA) 5000, to verify the reliability of corporate disclosures. ICGN Members will continue to scrutinize the degree to which companies are able to link sustainability related information with financial statements in a wholly integrated manner, clearly expressing how any risks and opportunities impact the business model and strategy in the pursuance of value creation and long-term sustainability of the organization.

11. Minimum standard for Audit Committees

ICGN agrees that Code companies should apply the Minimum Standard for Audit Committees ("Minimum Standard"). This is consistent with Guidance 8.3 of the ICGN Global Governance Principles which relates to the role of the Audit Committee including a responsibility to assess annually the quality and effectiveness of the external audit process and ensuring independence of the external auditor, including in relation to the provision of non-audit services. More generally, we welcome regulatory efforts to enhance competition and choice in the audit market to help ensure high standards of corporate governance and investor stewardship, thereby contributing to successful companies and long-term value creation.

12. Audit committee remit regarding sustainability reporting

ICGN welcomes mandatory sustainability reporting requirements, alongside those required for financial reporting. Mandatory disclosure requirements will help facilitate rigorous, consistent, and comparable corporate sustainability reporting, that enables investors to properly assess and price sustainability related risk, opportunity, and resilience in investee companies.

We encourage there to be greater alignment between sustainability related disclosures (particularly the implications of climate related transition plans and climate/biodiversity risks) and financial statements. This information should be quantifiable, financially material, and consistent with accounting standards. Both financial information and sustainability-related information should be explained in the company's annual report -i.e., published in advance of the annual shareholder meeting.

ICGN recognizes that many companies have a dedicated committee responsible for overseeing the establishment of sustainability related targets, metrics, and strategies to manage sustainability related risks and opportunities. We agree that the Audit Committee may also be appropriate in overseeing the company's approach to corporate sustainability reporting and assurance and agrees with the new drafting suggested in the Code in this regard under provisions 26 and 27.

The Audit Committee is likely to have the requisite experience in overseeing sustainability related disclosure and assurance given its responsibility for the integrity of the company's financial statements, internal controls, and external audit. We therefore agree that the Audit Committee is best placed to manage corporate sustainability reporting and assurance, while coordinating closely with any other relevant committee, such as a Sustainability Committee.

More generally, we recognize that many board members, particularly those serving on Audit Committees feel the need for enhanced support and expertise in dealing with sustainability related risks and opportunities. The Code might therefore emphasize the importance of the board and Audit Committee having the requisite skills, capacity and training to manage this.

Accountability for sustainability related corporate disclosure and assurance should be specified in the committee mandate and referenced in the annual report. More generally, we expect that this responsibility also be reflected in the board mandate, given the role of the board for ultimately affirming the reliability of a company's financial and sustainability related information in presenting a balanced and understandable assessment of the company's position and long-term prospects in the annual report and accounts.

13-18. Risk and internal controls

ICGN agrees with the proposed amendments in the Code to strengthen references to the effectiveness of risk management and internal control systems.

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We agree with the requirement for boards to confirm that they have put in place and maintain effective systems that deliver the expected outcomes thereby strengthening accountability for the effectiveness of the company's risk and internal controls framework. This is consistent with Guidance 6.1 of the ICGN Global Governance Principles which emphasizes *'that the board should assess annually the company's key risks, the potential probability and impact of such risks, and any mitigating actions and procedures. The board should ensure that the company has robust and effective risk management and internal control systems which should address all key risks.'*

We agree with the FRC's recommendation to replace the word 'financial' with 'reporting'. This will help ensure that a company's approach to risk management includes sustainability related factors that are also material to the ongoing success of a company and its ability to generate long-term corporate value.

We encourage improved disclosure from companies around the board's role to oversee the establishment and maintenance of an effective system of internal control to properly manage risk which should be measured against internationally accepted standards of internal audit and tested periodically for its adequacy. More generally, we observe that the maturity and sophistication of risk management and internal control systems will differ by company, and disclosure should adequately reflect all risks across the business.

Where an internal audit function has not been established, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained.

19. Going concern

ICGN agrees that Provision 30, which requires corporate boards to state whether they are adopting a going concern basis for accounting, should be retained in the Code.

Principle 7.10 of the ICGN Global Governance Principles refers to going concern as follows:

"The board should confirm in the annual report that it has carried out a robust assessment of the company's financial position, and identify any material risks, including to solvency, liquidity, and short-term continuity, that would threaten its continued viability. The board should state whether the company will be able to meet its liabilities as they fall due and continue in operation for the foreseeable future, explaining any supporting assumptions and risks or uncertainties relevant to that and how they are being managed."

20-21. Resilience statement

ICGN agrees with the FRC's approach to requiring all companies to report on 'future prospects' on the annual report as drafted in Principles 32. We believe that this also provides sufficient flexibility for non-public interest entities to report on the same under a comply or explain approach.

<u>Section 5: Remuneration</u>

22. Remuneration outcomes

We welcome specific language under Principle P to include environmental, social and governance objectives as part of a company's long-term strategy being linked with remuneration outcomes. The Remuneration Committee should, in collaboration with other relevant committees, where present, establish and review annually the performance metrics ensuring that rewards are proportionate with performance outcomes and are aligned with sustainability related risks and opportunities.

Remuneration Policies and related Reports should describe how CEO and senior executive remuneration is determined and deemed appropriate in the context of the company's underlying performance in any given year and over relevant time periods.

Additionally, ICGN welcomes reference to the workforce in the drafting under Principal, Q and Provision 35. CEO and executive remuneration should be reasonable and equitable in both structure and quantum determined within the context of a company's purpose, values, and strategic objectives. When setting pay levels, we encourage Remuneration Committees to consider the level of pay of the average company worker and relative to the average median income of the company's place of domicile. The rationale for individual levels should be disclosed, including how it fits within the overall context of the company's human resource strategy.

We also encourage improved disclosure around the **remuneration setting process** as well as the **proportions** of fixed pay, bonus, long-term incentives, and historical pay levels. This extends to non-cash benefits such as director and officer insurance, pension provisions and terms of severance packages if any.

23-24. Malus and clawback

ICGN welcomes new reference to malus and clawback in Provisions 39 and 40 to ensure that remuneration rewards may be withheld or recovered in the event of performance targets not being achieved as well as any misconduct, misstatement, or other serious failing. We also welcome required disclosures regarding the circumstances upon which such measures may be implemented. This will help to improve the quality of engagement with shareholders.

We encourage the FRC not to delete the original Provision 40 as this provides helpful guidance to Remuneration Committees on important elements to be addressed in Remuneration Policies.

25. Pay gaps and pay ratios

The Remuneration Committee should continue to provide an explanation in the annual remuneration report of pay ratios and pay gaps.

Thank you for considering our suggestions and we remain at your disposal should you have any questions.

Yours faithfully,

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