

UK Corporate Governance Code FRC consultation on proposed changes



April 2014

The Financial Reporting Council (FRC) has issued a consultation document on proposed revisions to the UK Corporate Governance Code.

The document includes proposed changes to provisions relating to directors' remuneration, risk management and going concern, and also seeks views on the possibility of giving companies the option to make the corporate governance report available on their website rather than in the annual report and accounts. This summary focuses on the proposed changes to the provisions relating to remuneration.

Directors' remuneration

The FRC was asked by the Government to consider amending the UK Corporate Governance Code in relation to three specific issues:

- Clawback arrangements
- Any actions that should be taken if a company fails to obtain a substantial majority in support of a resolution on remuneration
- Whether non-executive directors holding executive positions in other companies should sit on the remuneration committee

After considering the responses to the initial consultation on directors' remuneration released in October 2013, the FRC has published proposed changes to the Code. The changes are intended to encourage boards to focus on the long-term and increase their accountability to shareholders.

Responses to this consultation are required by 27 June 2014. Changes will apply to reporting years beginning on or after 1 October 2014.

Proposed changes

Focus on long-term success

It is proposed to amend the main principle D.1: The Level and Components of Remuneration and supporting principle. This is intended to provide clarity on the overall objective that remuneration policies should be designed to deliver long-term benefit to the company and to delete the reference to the need to be able to “attract, retain and motivate directors of the quality required”.

- **The main principle will now state that “Executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be stretching and rigorously applied”.**
- **The supporting principle will now include the requirement to avoid paying more than necessary. It will also make reference to both corporate and individual performance in relation to the need to be cautious about using comparisons with other companies and the danger of upward ratcheting with no corresponding improvement in performance.**

Extending the provisions on clawback

This proposal was strongly supported by investors. Many companies consider that the requirement to disclose the existence and use of these arrangements under the new disclosure regulations will have the desired effect of encouraging companies who do not already have provisions in place to introduce them. The FRC is proposing to include a provision relating to clawback in the Code, based on the same terminology as the Regulations, but is not proposing to specify how these arrangements should operate or the specific circumstances in which they might apply.

- **The provision will be added to provision D.1.1: “Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which the committee considers it would be appropriate to do so”.**

Therefore, if a company does not have clawback or malus arrangements in place it will be a requirement to explain why this is the case.

Votes against the remuneration report

The Code currently includes provisions relating to ensuring effective communication with shareholders and to the disclosure of the steps taken to ensure that the members of the board have an understanding of the views of shareholders. However, the Code does not explicitly state how boards should respond if the company fails to obtain at least a substantial majority in support of a resolution on remuneration.

The Regulations require, in the annual remuneration report, disclosure of the details of the votes on the previous year’s report and where there was a significant vote against either resolution, to give a summary of the reasons, where known, and any actions taken in response. However, this would not

be disclosed until the year after the event. Views were sought on whether there should be an explicit requirement in the Code to report to the market where the company fails to obtain a substantial majority in support of a resolution on remuneration.

Responses to this question were mixed. Some consider that the requirements of the Regulations will be sufficient to ensure engagement on issues of concern while others consider that further prompting through the Code would be helpful. There was also a concern that singling out remuneration in this way may send out a signal that this is considered more important than engagement on strategy, board composition and other important matters.

The proposal is therefore to add a provision to Section E.2 which deals with the constructive use of the AGM, covering all resolutions, not just those relating to remuneration. The intention is that companies should set out how they intend to engage with shareholders to assess their concerns, not how they intend to address these concerns. The Code does not define what constitutes a 'significant proportion' and this will be left to each company to assess.

- **The provision will be added to provision E.2.2: “When in the opinion of the board, a significant proportion of shareholders have voted against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result”.**

Remuneration committee membership

Views were sought on whether changes to the Code are required in order to deter the practice of executive directors serving as members of a remuneration committee in another listed company. There was very little support for a recommendation against this practice as there is little practical evidence that current practices are creating any governance issues and therefore the FRC does not intend to take this proposal any further.

The FRC does believe however that companies could do more to explain why individual directors are the most appropriate persons to serve on the board and on the committees and will continue to monitor disclosure in this area. The FRC is also undertaking work to identify good practice in succession planning and the process by which directors are appointed, in order to help improve the balance and diversity of boards and committees.

Conflicts of interest

The FRC is proposing to amend the supporting principle in D.2: Procedure, to remove any potential ambiguity in relation to the remuneration committee consulting the chief executive about proposals relating to other executive directors. The amended principle now reads:

“The remuneration committee should take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management, or consulting the chief executive about its proposals. The committee should be responsible for appointing any consultants in respect of executive directors’ remuneration”.

Other changes

The FRC is proposing a number of changes to Schedule A – The design of performance-related remuneration. These are designed to further encourage the focus on the long-term success of the company and the consideration of arrangements for deferred remuneration including vesting and holding periods.

The changes include:

- **Moving the reference to non-financial performance measures and ensuring incentives are compatible with risk policies and systems to the first paragraph, and including a reference to determining a balance between deferred and immediate remuneration. The paragraph now reads:**

“The remuneration committee should determine an appropriate balance between immediate and deferred remuneration. Performance measures, including non-financial metrics where appropriate should be relevant, stretching and designed to promote the long-term success of the company. Remuneration incentives should be compatible with risk policies and systems. Upper limits should be set and disclosed”.

- **Extending the recommendation relating to the consideration of whether directors should be eligible for benefits under long-term incentive plans to include consideration of whether directors should be eligible for annual bonuses.**
- **Introducing a recommendation that committees should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company.**

The reference to clawback in this Schedule has been removed as this has now been incorporated in the Code provisions.

The full consultation paper can be found on the FRC website: www.frc.org.uk.

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