

## UK Corporate Governance Code Changes to the Code



September 2014

**Following the recent consultation, the Financial Reporting Council (FRC) has issued revisions to the UK Corporate Governance Code.**

The changes relate to directors' remuneration, risk management and going concern. This summary focuses on the changes to the provisions relating to remuneration which are substantially the same as those proposed in the consultation document.

The revised Code applies to reporting years beginning on or after 1 October 2014 and applies to all companies with a premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

### **Focus on long-term success**

Principle D.1: The Level and Components of Remuneration and supporting principle now emphasises that the overall objective of the remuneration policy should be to deliver long-term benefit to the company. The reference to the need to be able to "attract, retain and motivate directors of the quality required" has been deleted. There has been a slight change from the proposed wording, adding that performance related elements should be transparent as well as stretching and rigorously applied.

- **The main principle now states that "Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied".**
- **The supporting principle now includes the requirement to avoid paying more than necessary. It also makes 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

The Code now includes a specific provision relating to clawback (using the same terminology as the Directors' Remuneration Report Regulations (Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations). Provision D.1.1 has therefore been extended to include:

**“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”.**

## Votes against the remuneration report

A provision has been added to Section E.2 which deals with the constructive use of the AGM, covering all resolutions, including those on 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 following has been added to provision E.2.2:

**“When in the opinion of the board, a significant proportion of votes have been cast 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”.**

## Conflicts of interest

The supporting principle in D.2: Procedure has been updated 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

A number of changes have been made 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 fixed and variable, and deferred and immediate remuneration. The first paragraph now reads:**

**“The remuneration committee should determine an appropriate balance between fixed and performance-related, immediate and deferred remuneration. Performance conditions, 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”.**

- **The provision relating to the consideration of whether directors should be eligible for benefits under long-term incentive plans now extends to include the consideration of whether directors should be eligible for annual bonuses.**
- **Introducing a provision 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 Schedule A has been removed as this has now been incorporated in the Code provisions.

#### ***Deloitte view***

*We welcome the change to the main principle on remuneration which puts the key focus on designing remuneration to promote the long term success of the company and ensuring that variable remuneration is transparent and tied to stretching and rigorous performance targets. We also believe the change to provision D. 2 will be helpful in encouraging the remuneration committee to be aware of the potential conflicts of interests when considering the views of the CEO and other executive directors.*

*The announcement of voting outcomes is usually made soon after the conclusion of the general meeting and companies may therefore want to consider developing a process to be actioned if there are situations where there is a significant vote against a resolution.*

*The most significant change is that relating to clawback. Previously clawback was mentioned only in Schedule A of the code, requiring companies to have given consideration to the use of provisions that would permit the reclaiming of variable components in exceptional circumstances of misstatement or misconduct. From 1 October 2014 (the first companies to report under the new Code will be those with financial year ending on 30 September 2015) it will be a requirement to provide an explanation if provisions are not in place for the company to be able recover sums paid or withhold the payment of any sum in certain circumstances. Companies do not need to specify how these provisions will operate but are required to specify the circumstances in which these provisions may apply. Many companies now include clawback and/or malus provisions in relation to variable pay. The wording of the Code is a little ambiguous in that it may be taken to imply that companies should have the ability to apply both clawback and malus or alternatively that having either clawback or malus provisions may constitute compliance. However, remuneration committees may want to consider having the ability to apply both clawback and malus in certain circumstances and should focus on the implication of these changes. This will include what practical steps need to be taken,*

*what documentation may be required, the extent to which this may constitute a change to current policy and the implications for disclosure.*

*We are holding a webinar to discuss some of the practical implications of introducing clawback and malus provisions on Thursday 25 September at 11.00am. You can register for this session at [www.deloitte.co.uk/events](http://www.deloitte.co.uk/events) using the password 'update'.*

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