



A new Corporate Governance Code for UK listed companies

On 16 July 2018, the FRC published the final form of its new UK Corporate Governance Code and guidance on board effectiveness, which will apply to all companies with a premium listing of equity shares (whether or not UK incorporated) for reporting years starting on or after 1 January 2019.

This means that reporting on the new requirements will begin in 2020, covering activities undertaken, and information collected, in 2019.

Much of the Code is the same as the version on which the FRC consulted at the end of 2017 - see [here](#) for our briefing on that draft. This update focuses on the changes from the draft Code that have become incorporated into the final Code.

The most notable changes relate to:

- the independence and length of tenure of NEDs and the chair; and
- the role of the remuneration committee.

At the end of this briefing is a checklist of some key Code-related points that may assist your planning in the coming months, alongside your preparation for the new statutory governance reporting requirements that will apply from the same date (see our [briefing](#)).

The FRC has added wording into the introduction to the Code emphasising the need for boards to ensure that there is adequate cooperation within the group to enable boards to discharge their governance responsibilities under the Code effectively - this includes the communication of the parent company's purpose, values and strategy.

Engagement with workforce and other stakeholders

The FRC has recast its original proposals about stakeholder engagement, whilst continuing to emphasise its importance. The final Code provides that the board should:

- understand the views of the company's key stakeholders;
- describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making (the Code describes this as supporting the new statutory governance reporting requirements); and
- keep engagement mechanisms under review so they remain effective.

The draft Code's three stated methods for workforce engagement are unamended - ie (i) a director appointed from the workforce; (ii) a formal workforce advisory panel; and (iii) a designated non-executive director. However, the final Code introduces extra flexibility by making clear that a combination of these methods can be used and by making it explicit that it is open to the board to adopt a different approach if it wishes, although, if it does so, it will be required to explain what alternative arrangements are in place and why it considers these to be effective. In other words, the final Code acknowledges that companies can choose alternative arrangements to establish the 'workforce voice' within their organisation as long as they explain what those arrangements and how they operate.

The board guidance provides that ‘workforce’ in this context means (i) those engaged on employment contracts (permanent, fixed-term and zero-hours) and (ii) other members of the workforce who are affected by decisions of the board - the guidance does not expressly provide for which individuals should be included in (ii) but it does state that companies should consider including employees, agency workers, and remote workers regardless of their geographical location. The guidance provides that companies should be able to explain whom they have included and why – this suggests that there is some flexibility on which members of the workforce to include provided this is explained.

The Code confirms that companies should establish a whistleblowing procedure under which the workforce can report anonymously; the Principle now states that the workforce should be able to raise any matters of concern.

Significant votes against resolutions

There have been clarificatory changes to the provisions for company reports where there are significant votes against resolutions (20% or more of votes) - including that this only applies to resolutions in relation to which the board has made a recommendation (whether to vote for, or against, a resolution). This provision applies to both board proposed and shareholder requisitioned resolutions. As with the draft, the final Code provides that the company should publish an update within six months with follow-up disclosures in the annual report. The FRC has indicated that these provisions apply during 2019.

Chair’s independence and tenure

The FRC has reconsidered its position on the independence of the chair. Under the final Code, the chair will continue to be independent on appointment (as is currently the case) but will not have to be independent throughout their tenure, as the FRC proposed in its consultation. In its feedback statement the FRC recognises the ‘special’ role of the chair, a subject on which it received extensive feedback in consultation and which has led it to revert to the 2016 Code position on chair independence. In addition, however, there is a requirement in Principle F that the chair ‘should demonstrate objective judgement throughout their tenure’.

The FRC has, however, added a new provision that the chair should not remain in post beyond nine years from the date of first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing NED on appointment. A clear explanation should be provided. This appears to seek to address the concern raised by many respondents that a nine year time limit could make it more difficult for existing NEDs to graduate to the role of chair if time spent on the board as a NED counted towards the nine years.

Board independence

The FRC has withdrawn its proposal in the draft Code that a NED ‘should not’ be considered independent if any one of the specified circumstances exists. This change in the FRC’s position reflects wide-ranging concerns raised in the consultation about the proposed change in approach. As a result the FRC has reinstated the 2016 Code provision under which it is a matter for the board to determine whether, notwithstanding that one of the specified circumstances applies to a NED, that NED is still considered to be independent. The FRC has indicated that it expects to see greater detail when companies report on the independence of board members.

The draft Code also provided that independent NEDs, including the chair, should constitute the majority of the board. As a result of the Code reverting to a position where the chair is considered independent on appointment only this has been dropped, and the position as set out in the 2016 Code will continue to apply, namely that at least half the board, excluding the chair, should be NEDs whom the board considers to be independent (although the smaller companies exemption in the 2016 Code has been removed).

Directors’ time commitments

The final Code has extended the provision that a full-time executive director should not take on more than one non-executive directorship of a FTSE 100 company to cover other significant appointments. It has added provisions that require the board to take into account other demands on a director’s time when making new appointments and that significant commitments should be disclosed with an indication of the time involved before appointment.

Diversity

The responses to the FRC's proposals on diversity were generally supportive and the new emphasis in the Code on diversity of all types was welcomed. The FRC has given extra support to efforts to promote diversity by replacing 'chairman' with 'chair' in the Code.

Expanded nomination committee role

The FRC has made a few changes to the provisions on what the annual report should say about the nomination committee's work. In relation to diversity, the wording has been aligned more closely to the diversity reporting requirements in DTR 7. The FRC has expanded the committee's reporting on board evaluations to include the nature and extent of an external evaluator's contact with the board and individual directors.

Expanded remuneration committee role

The final Code expands the role of the remuneration committee but this expansion is now more limited than had been suggested in the draft Code and relates only to the following aspects of its role:

- its remuneration-setting responsibilities will be extended to include senior management; and
- when setting executive director remuneration, it will now be required to review and take into account workforce remuneration and related policies and the alignment of incentives and rewards with culture. The guidance indicates that this review should include matters such as pay principles applied across the company, base pay, benefits, and all incentives and aspects of financial and non-financial reward that drive behaviour regardless of where this is managed in the business.

This more limited expansion is to be welcomed. The draft Code provided that the remuneration committee should have 'oversight' responsibility for remuneration and workforce policies and practices for the wider workforce. This gave rise to significant concerns that this would result in the committee having a greatly expanded remit which could encroach into operational responsibilities. The board is now given responsibility for ensuring that workforce policies and practices are consistent with the company's values and support its long-term sustainable success (Principle E) – the FRC has acknowledged that oversight of these policies and practices is properly a matter for the wider board and not within the scope of the remuneration committee's role.

'Workforce' in this context is defined in the guidance and is narrower in scope than the definition used for workforce engagement. Here it means any individuals who are engaged under an employment contract or a contract or other arrangement to do work or provide services personally. This definition would include employees, 'workers' and self-employed consultants but would exclude agency workers and contractors' employees.

The final Code retains the requirement that had been included in the draft Code for the committee's chair to have had 12 months' prior remuneration committee experience on appointment.

Remuneration

There is a continued emphasis on the promotion of long-term shareholdings with minor changes to the requirements applicable to share awards. The final Code provides that:

- share awards should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more;
- the remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.

The final Code clarifies the draft Code's requirement on pension alignment between the executive directors and the workforce, acknowledging that many executives receive a payment in lieu of a pension contribution. The final Code provides that the pension contribution rates for executive directors, or payments in lieu of pension contributions, should be aligned with those available to the workforce. This reflects an increasing focus of institutional shareholders.

The final Code includes 'risk' as an additional item which the remuneration committee should address when determining executive director remuneration policy and practices, stating that remuneration arrangements should ensure that reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.

Next steps

- The FRC will be increasing its monitoring of governance practice and reporting, including more in-depth reviews of annual reports.
- The FCA is reviewing its handbook and considering what consequential amendments are needed.
- The FRC will be making consequential changes to the Guidance on audit committees and Guidance on risk management, internal controls and related and financial business reporting – in particular to assess whether amendments are required in relation to internal controls and viability statements in light of the outcome of investigations into the Carillion collapse.
- The FRC will be consulting on a revised Stewardship Code later in 2018.

Complying with the Code - 2019 onwards

Workforce / other stakeholder engagement	<ul style="list-style-type: none"> • Review how you obtain and take account of workforce views • Review your whistleblowing policy and procedure
Board decision-making	<ul style="list-style-type: none"> • Consider whether board papers and minutes have appropriate scope and detail
Directors' time commitments	<ul style="list-style-type: none"> • Consider whether directors' external commitments should be reviewed
Diversity	<ul style="list-style-type: none"> • Reassess your efforts to promote diversity (of all types)
Directors' training	<ul style="list-style-type: none"> • Review induction and ongoing development needs for each director
Board evaluation	<ul style="list-style-type: none"> • Review the scope and process of evaluations for the board, committees and individual directors
Nomination committee	<ul style="list-style-type: none"> • Look at the committee's responsibilities and terms of reference, especially on process for board appointments, board and senior management succession planning, diversity and directors' external commitments
Remuneration committee	<ul style="list-style-type: none"> • Look at the committee's composition, responsibilities and terms of reference.

Annual reporting - looking forward to 2020

We will see many changes to annual reports for 2020 onwards, reflecting new statutory governance reporting requirements (a number of which apply to certain large privately held companies - see our briefing for more details) as well as the new Code. For example, you may need to review and expand the information your reports provide about:

- how directors have engaged with the workforce and other stakeholders, and how their interests and the matters set out in section 172 of the Companies Act 2006 have influenced the board's decision-making;
- board and director evaluations;
- directors' external appointments;
- the nomination committee's role in relation to diversity of all types; and
- the description of the work of the remuneration committee to ensure it includes those matters specified in Provision 41.

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