Breakfast with Sir Win Bischoff

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Audit Committee Institute part of the KPMG Board Leadership Centre

Sir Win Bischoff, Chair of the Financial Reporting Council (FRC), joined our FTSE100 audit and risk committee chairs' breakfast to share his insights in respect of the proposed 2018 UK Corporate Governance Code and a number of other current corporate governance initiatives.

The UK Corporate Governance Code

The revised Code – expected mid-July – is intended to be shorter and sharper than previous versions, and have greater emphasis on principles and the value of good corporate governance to sustainable growth.

Proposals around the tenure of board chairs was the single issue that raised most comment from those responding to the draft proposals. While noting the argument that the 'nine year rule' might impact the attractiveness of internal appointments (where one might expect an individual to serve several years on the board before 'promotion'); Sir Win also remarked that the average tenure for FTSE100 chairs is currently around five years. This is clearly an area the FRC have looked at and it remains to be seen whether the initial proposals will change.

On wider stakeholders and directors duties, the proposals are that boards should establish a method for gathering the views of the workforce and that this would normally be a director appointed from the workforce, a formal workforce advisory panel or a designated non-executive director.

On executive pay, Sir Win noted the on-going public disquiet and the concerns around the complexity of remuneration arrangements, the role of incentives in driving behaviour and the correlation between executive pay and the experiences of the wider workforce.

Corporate governance for large private companies

Consistent with the Prime Minister's view that the case has been made for strengthening the corporate governance framework for the UK's largest private companies, amendments to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 have been laid in Parliament.

The intention is to require all companies of a significant size to include a statement within their directors' report that details which, if any, corporate governance code the company applies, and *how* the company applies that corporate governance code. For the purposes of this requirement the word 'code' should be interpreted broadly – and with this in mind, the final Wates Corporate Governance Principles for Large Private Companies will assist companies in fulfilling this new requirement by promoting best practice corporate governance within large private UK companies.

The new disclosure requirement will apply to UK companies with 2,000 or more employees globally. If companies do not meet this employee threshold, but do have a turnover of more than £200 million and a balance sheet of over £2 billion, they will also be within scope of the new requirement. Subsidiaries of listed companies which meet these thresholds will also be within the scope of the new requirements.

Interestingly, the *Wates Corporate Governance Principles for Large Private Companies* adopt an 'apply and explain' approach rather than the familiar 'comply or explain' model applicable to listed companies. The emphasis is very much on *how* the Code principles have been applied rather than *whether* they have been applied.

Key themes

Some of the key themes arising from the discussion were as follows.

Prescription - While there is a perception that corporate governance is becoming more prescriptive, the UK Corporate Governance Code is, of course, a 'comply or explain' Code (and the new Wates Code is 'apply or explain'). The FCA's Senior Managers Regime is more prescriptive, but most considered that such a regime would be inappropriate beyond the financial sector.

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That said, it is understandable that politicians and the media edge towards more regulation in an environment where the impact on those deemed responsible for corporate failure is difficult to observe. Section 172(1) of the Companies Act 2006 – the duty to have regard for employees and other stakeholders - appears to have no legal 'teeth'.

Stewardship challenges - A perceived challenge to effective stewardship in the UK is the apparent mismatch between the duty of boards to – when promoting the success of a company - have regard for the long-term and a wide group of stakeholder interests; and the interests of fund managers who may be more focussed on relative performance and short term wealth creation.

The director's job is becoming tougher and the ability to rely on a significant cohort of 'loyal' shareholders is on the wane, at the same time as public scrutiny of listed boards is on the increase. It was thought that this could ultimately impact the pool of candidates willing to join large listed company boards (particularly within the financial sector) though it is positive that more women are joining company boards.

Investor dialogue - The continuing lack of dialogue between audit committees and the investor community is worrying. Remuneration committees receive a lot of institutional investor attention and are in the media spotlight; but it shouldn't be that way.

In light of the proposed Code provision 'requiring' committee chairs to engage with shareholders on significant matters related to their areas of responsibility, audit committee chairs may need to redouble their efforts. Nevertheless, success will also require the commitment of the investor community (and that might in turn require additional resources being deployed in this area).

The FRC's investigatory powers - The powers to investigate and take disciplinary action against directors in cases of misconduct are very fragmented. The FRC currently has the ability to sanction actuaries and accountants, but has no power over company directors *per se*.

A simplification of this regime may be one of the outcomes of the on-going Kingman review.

Global convergence - There is some global convergence. Europe have largely adopted the 'comply or explain' approach; the PCAOB have shown some interest in the UK model of having Independent NEDs within the audit firms; and the SEC are now thinking hard about corporate culture. That said, the SEC are unlikely to abandon their 'hard and fast' rules (which have their merits) in favour of a 'comply or explain' framework.

Thinking more broadly, the zeitgeist is moving away from the idea of 'shareholder value' to one where the long term health of organisations (in a much wider sense) is the priority. It is notable that in his annual letter to CEOs, BlackRock Inc's chairman and CEO, Larry Fink, writes that in order to prosper over time every company must not only deliver financial performance but also show how it makes a positive contribution to society.

Societal expectations - Contractual obligations entered into some time ago can now look very 'wrong' – whether that be remuneration arrangements, non-disclosure clauses or other matters.

The emphasis in the revised Code on the role of the board in exercising independent judgement and discretion – and the new Provision requiring (on a 'comply or explain' basis) schemes to make provision for boards to be able to override remuneration outcomes (for example, where the measurement of any performance condition does not reflect the actual performance of the company over the period, or the performance of the individual director) – will go some way to address this issue.

Proxy agencies - Unless there is a better dialogue with the two or three major proxy agencies, there is a risk that they will have a disproportionate impact on the UK corporate governance framework. Ultimately, long-term strategies are difficult to pursue unless both shareholders and proxy agencies (and other stakeholders) are engaged with the board.

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