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For the attention of:
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UK Corporate Governance Code Consultation – response from the Institute of Directors (IoD)

About the IoD

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 20,000 individual members. Its aim is to promote good governance and ensure high levels of skills and integrity among directors of organisations. The membership is drawn from right across the business spectrum, as well as the public and third sector. However, the majority of members, some 70%, comprises directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies in all sectors.

The IoD welcomes the opportunity to participate in this consultation on the UK Corporate Governance Code. The Royal Charter of the IoD requires the Institute to "promote the study, research and development of the law and practice of corporate governance, and to publish, disseminate or otherwise make available the useful results of such study or research". It also mandates the IoD to "represent the interests of members and of the business community to government and in all public fora and to encourage and foster a climate favourable to entrepreneurial activity and wealth creation". It is with both of these objectives in mind that we submit our views on the proposed revisions to the Code.

Executive summary

- The IoD is a strong advocate of a principles-based approach to corporate governance regulation, which allows for some degree of flexibility in how principles are applied in specific circumstances. This has underpinned our support for the UK Corporate Governance Code over the years.

- We do not believe that the Code is currently deterring significant numbers of companies from listing in the UK. However, we feel that the FRC could emphasize, to an even greater degree than at present, the flexibility inherent in the Code and the importance of avoiding a 'tick box' approach to assessing standards of governance. The Code needs to be perceived as providing UK business with a source of competitive advantage compared to other regulatory regimes based on mandatory rules.

- However, notwithstanding its relative flexibility, the Code must avoid being too prescriptive about how boards organise their activities. As a general rule, boards are better placed than regulators to determine the best interests of their companies. We feel that the FRC broadly gets the balance right, but there are some areas where we have concerns.

- For example, the FRC is recommending that the audit committee should take responsibility for ESG disclosures, controls, processes, and assurance. However, an individual board might reasonably determine that a sustainability committee, an ESG committee or the board as a whole is the more appropriate mechanism through which to oversee these areas – especially if the audit committee is already overburdened. We should preserve the ability of boards to make judgements of this nature.

- Our members are concerned about the substantial volume of reporting, declarations and disclosures which the Code and other regulatory requirements are imposing on companies. As well as being costly in terms of time and resources, they bring into question the utility of annual reports, which are increasingly lengthy, complex and difficult to navigate. The Code should seek to obviate these concerns by minimising the reporting burden wherever possible.

- For example, when reporting on the effectiveness of their risk management and internal control systems, the Code should encourage companies to adopt a high threshold in terms of materiality, clarity and succinctness rather than a scattergun approach. Stakeholders (including investors) are mainly concerned with gaining a sense of reassurance that the board is equipped to deal with any problems. They are not well-

placed to second-guess the board's detailed oversight of these areas, and it would be counterproductive to encourage them to do so.

- Executive pay is a controversial issue, and the FRC are right to tighten the Code's provisions in this area. In particular, is important for the reputation of the entire UK business community that senior executives are not seen as being rewarded for failure or misconduct. Hence, we support the greater transparency in the Code around malus and clawback, and also for the recognition of such sanctions in employment contracts.

The UK Corporate Governance Code

- Companies with a premium listing on the London Stock Exchange (around 900 companies) are required to report against the UK Corporate Governance Code.
- The Code is principles based, and companies are expected to apply these principles. More prescriptive recommendations are stated in the form of provisions (of which there are around 40). Companies may either comply with these provisions or explain their reasons for not doing so ('comply or explain'). Hence of a degree of flexibility is allowed for in the application of the Code.
- The current set of proposed reforms are not as wide-ranging as those made in 2018. The Code retains the same broad structure, with 5 sections relating to differing aspects of the role of the board of directors:
    1. Board leadership and company purpose.
    2. Division of responsibilities
    3. Composition, succession and evaluation
    4. Audit, risk and internal control
    5. Remuneration
- The main driver of the current proposed changes is the Government's 2021 White Paper, 'Restoring trust in audit and corporate governance', which set out proposals to strengthen the UK's framework for major companies and the way they are audited. The revisions to the Code are an important component of these reforms, and primarily relate to internal control, internal and external assurance, ESG reporting, the role of the audit committee and executive pay arrangements.
- The revised Code will apply to accounting years commencing on or after 1 January 2025.

IoD perspective on the UK Corporate Governance Code

The Code's key strength - 'comply or explain'

The IoD is broadly supportive of the changes that are proposed for the Code. We are strong advocates of a principles-based approach to corporate governance regulation, which allows for some degree of flexibility in how principles are applied in specific circumstances. In our view, this kind of approach is both more effective and more business-friendly than a regulatory system that is overwhelmingly based on mandatory rules.

However, the effectiveness of 'comply or explain' is highly dependent on the willingness and capacity of investors and other stakeholders (including index providers, proxy advisers, foreign investors and regulators) to thoughtfully consider, and potentially accept, possible deviations from the Code. Our perception is that this does not always happen. There can be a tendency amongst some actors to assume that any deviation from the Code is representative of 'poor governance'.

As a result, some boards may feel under pressure to fully comply with the Code, even if there are some aspects of it that are not appropriate for the circumstances of their enterprise. This is an undesirable outcome as it may give rise to feeling in the business community that the Code is becoming a regulatory 'burden' which is detrimental to economic growth.

We do not share the view expressed by some commentators that the Code has become a deterrent to listing in the UK. However, we do feel that the FRC could emphasize, to an even greater degree than at present, the flexibility inherent in the Code and the importance of avoiding a 'tick box' approach to assessing standards of governance. The Code should not be presented as a means by which the role of the board is defined or judged, but rather as suite of 'good practices' that supports directors in their decision-making processes.

Preserving director judgement

The importance of preserving director judgement was emphasized in a recent paper published by the IoD Centre for Corporate Governance ('Are Boards Losing Control?'). We observe that there is a growing perception amongst UK directors that they are no longer fully in control of setting their company's direction. Regulators, investors and other influencers, whose priorities may not always be aligned with those of the company, are becoming increasingly prescriptive and arguably encroaching into areas of responsibility that rightly belong to the board.

This is a worrying development. Directors assume ultimate legal responsible for the company. The concept of board leadership is based on the premise that the board is the best placed forum within which to take decisions in the company's interest. This is because the board has access to expertise, experience and information which is not available to other actors to the same extent.

However, if directors' ability to make informed and nuanced judgements is circumscribed to an excessive degree (e,g, by the Code or other regulatory requirements), then lines of accountability will be blurred and the outcome for the company is likely to be sub-optimal.

Balancing the need for changes to the Code with the importance of preserving the board's discretion is an important consideration when evaluating any proposed changes to the Code. Overall, we feel that the FRC has achieved a reasonable balance in the proposed revisions. However, we do have some concerns, which are detailed below.

The growing burden of corporate reporting

Another important issue highlighted by IoD members relates to the growing burden of corporate reporting. Although this concern is being addressed in a separate consultation process, it is also relevant to the Code consultation – as both the proposed revisions to the Code and the associated new reporting requirements announced by government (e.g. relating to the publication of a Resilience Statement and other declarations) will expand the volume of disclosure that will be required of large UK companies.

Although each individual reporting requirement may be well-intentioned, their cumulative effect is to increase the complexity and unwieldiness of annual reports beyond the point of usability. In the words of one IoD member, "I question how many people read the reports and whether the cost of preparing all this data is less than the overall benefit it provides." Beyond a certain level of disclosure, diminishing returns start to set in.

It is therefore important to consider whether the new disclosures proposed for the Code are not only being added simply because they "seem like a good idea" but also whether stakeholders (particularly investors) actually need the information in order to constructively engage with boards or make investment decisions.

One size does not fit all

Many IoD members are directors of small and medium-sized enterprises, and will not be directly affected by the changes to the Code. Nonetheless, the Code is often held up as an exemplar of good governance practices across a wide range of organisations (including in the public and not-for-profit sectors). It is important to stress that the provisions of the Code should only be applied to organisations outside of the listed segment with caution, and following a critical assessment by boards of directors. In governance, one size does not fit all.

Although broad governance principles - such as accountability, transparency, and ethical leadership – are relevant to all organisations, the manner in which they are best embodied in specific entities is likely to vary, and a key role for any board of directors is to tailor good governance to specific circumstances.

Director training – a neglected issue

Over the years, the IoD has made frequent representations to the FRC to incorporate a greater emphasis on director training and professional development in the Code. In our view, directors should conceive of themselves as a professional group – with clearly defined prerequisites in terms of training, expertise and conduct - rather than simply being office holders in specific organisations. The IoD's Chartered Director qualification seeks to advance this agenda in a very direct way.

Whilst we recognise that there may be a reluctance amongst directors of premium listed companies to undergo this kind of rigorous director training, we feel that an absence of any kind of emphasis on professional development in the Code is a missed opportunity. Director education provides an opportunity for directors to engage with the spirit of Code rather than treating it as a compliance exercise that may be largely delegated to other employees or advisers.

The changes that are needed

Notwithstanding our comments above, we agree that a number of changes to the Code are warranted. Some of these will reflect the specific lessons learned from a number of recent high-profile corporate collapses (e.g. Carillion, BHS, Patisserie Valerie). Others will seek to embed changing societal norms around the role of business in modern society, e.g. with regard to issues of climate change, diversity and inclusion, and role of stakeholders other than shareholders in business decision-making.

In the following section, we provide our views in respect of specific consultation questions. Please note that we have deliberately included repetition of material outlined in the consultation document in order to facilitate the understanding of readers who may be reviewing our response on a stand-alone basis.

Finally, in the appendix to this paper, we provide the results of a recent survey of IoD members which relates to a number of the issues addressed by the consultation.

Responses to individual consultation questions

Q1: Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

We have concerns.

The new wording proposed for Principle D is as follows:

- *"When reporting on its governance activity the board should focus on outcomes in order to demonstrate the impact of governance practices and how the Code has been applied."*

We understand the motivation behind this emphasis on outcomes-based reporting. There is an obvious need for reporting to avoid boilerplate language, and be tailored to the specific circumstances of the company.

However, we fear that there may be some uncertainty around how 'outcomes' reporting should be implemented in practice. Are we talking about outcomes such as the overall performance of the company or the avoidance of a major scandal? Or are we referring to something more directly related to a specific governance process or policy? How should a company evidence the line of causation between the adoption of governance practices and a specific outcome?

Without more specific guidance and training on how to formulate and justify outcomes-based reporting, there is a risk that we will end up with a different kind of boiler-plate response – in which unjustified or tenuous claims are asserted with regard to the impact of specific governance practices.

Q2: Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance?

We agree.

The relevant new wording of Provision 1 of the Code is as follows:

- *"It [*the board*] should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how environmental and social matters are*

taken into account in the delivery of its strategy, including its climate ambitions and transition planning."

We agree with this wording.

Q3: Do you have any comments on the other changes proposed to Section 1?

We have concerns.

We are supportive of the new wording in Provision 3:

- *"The chair should ensure that the board has a clear understanding of the views of shareholders, and report in the annual report on the outcomes of the engagement which has taken place with them during the reporting period."*

However, we believe that the above should not just apply in respect of shareholders. It is also relevant with respect to other important stakeholders. It should be a matter for the board to determine who 'important stakeholders' are in the context of the company's specific circumstances.

Q4: Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

We have concerns.

The proposed wording is as follows:

- *"The annual performance review should consider each director's commitments to other organisations, and their ability to discharge their responsibilities effectively."*

We have concerns about this addition to the Code. Drawing on the IoD's own experience of conducting board reviews, the issue of directors' other work commitments outside of the company is not typically considered in many of these review methodologies. In fact, most reviews tend to concentrate on the dynamics of the board as a whole rather than the contribution of any individual director.

In our view, it is inherently difficult (and undesirable) for external reviewers to assess the performance of individual directors. However, a review of individual director performance (including the impact of external commitments) is an appropriate issue for an internal board review led by the chair.

A better way for the Code to address the issue of overcommitment would be to amend Principle G as follows:

- *"Non-executive directors should have sufficient time to meet their board responsibilities, and their ability to do so should be regularly reviewed. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account."*

Q5: Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

We have concerns.

The new wording is as follows:

- *"All significant director appointments should be listed in the annual report, describing how each director has sufficient time to undertake their role effectively in light of commitments to other organisations. This should describe any actions taken as a result of this assessment."*

We feel that this new requirement is excessively prescriptive. It is obviously essential for the board to have full view of a director's other appointments and to assess if they give rise to conflicts of interest or an excessive call on the director's time and attention. However, such an assessment may not be straightforward. The board may need to balance a variety of considerations when assessing if a director's appointment is in the best interests of the company. In some cases, a potential director may have limited additional capacity in terms of time, however the board may still judge it beneficial to the company for the director to be appointed.

This is an issue where we need to trust the board to make the right decision based on their inside knowledge of the context in which the company finds itself. A full listing of directors' other roles in the annual report would invite second-guessing by external observers based on limited knowledge of the various trade-offs (some of which should appropriately remain confidential) that the board is taking into account.

In our view, this is an example of where a Code recommendation would be signalling an underlying lack of trust in boards rather than empowering them.

Q6: Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

We agree.

This question relates to the treatment of diversity and inclusion in Section 3 of the Code. In particular, it asks if the proposed wording in the Code joins up with related requirements in the Listing Rules - for certain listed companies to include a 'comply or explain' statement in their annual report on whether they have achieved targets for women and ethnic minority representation on their board, and the publication of a standardised numerical disclosure on the ethnic background and gender identity or sex of their board, key board positions and executive management team.

The new wording in the Code includes:

- *"They [appointments and succession plans] should promote equal opportunity, and diversity and inclusion of protected characteristics and nonprotected characteristics including cognitive and personal strengths." (Principle I).*

- *"Diversity and inclusion initiatives, along with any targets set, should contribute to the succession plan." (Provision 18).*

There is also new wording around how diversity and inclusion progress should be reported in the annual report in relation to the work of the nomination committee (Provision 24). It should provide explanations of:

- *"…how the committee has overseen the development of a diverse pipeline for succession."*
- *"The effectiveness of the diversity and inclusion policy, including progress towards company objectives and adherence to established initiatives."*
- *"The gender balance of those in the senior management and their direct reports."*

We support this new wording, and believe that it is consistent with other regulatory requirements. In addition, we refer readers to the findings of a recent IoD Commission, 'The Future of Business: harnessing diverse talent for success', which provides practical guidance for employers on how to create working environments in which all talent – with specific

reference to disability, ethnicity, gender and sexual orientation – can thrive and contribute to business bottom-line and growth.

Q7: Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

We agree.

The relevant section of the Code is as follows:

- *"Both appointments and succession plans should be based on merit and objective criteria. They should promote equal opportunity, and diversity and inclusion of protected characteristics and nonprotected characteristics including cognitive and personal strengths".*

We agree with this proposed wording, including the way in which it broadens the concept of diversity. Addressing gender and ethnicity imbalances on boards and in the wider workforce has been (and continues to be) a key task for directors and policy makers. However, other diversity characteristics can also play a huge role in enhancing company performance, and this should be recognised in the Code.

Q8: Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

We agree.

As stated above, we welcome the recommendations for more transparency in these areas. Succession planning is a crucial aspect of good governance, but is often neglected by boards particularly in respect of senior management succession. There are obviously sensitivities associated with this issue. Nonetheless, it is desirable that the Code should encourage boards to face up to its importance. Stakeholders do not necessarily need to know all of the details. But they should be provided information which reassures them that the board has thought about the issue in a thorough manner and developed a credible plan.

Q9: Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

We have concerns.

We support the conclusion of the CGI 'Review of the effectiveness of independent board evaluation in the UK listed sector' that regulators should not be too prescriptive about the methodologies of board review processes. Board reviews may justifiably seek to evaluate board performance in different ways at different times. Diversity and innovation in board review processes should be accommodated by the Code.

We are somewhat sceptical about the need to mandate the term 'board performance review' instead of 'board evaluation'. According to the CGI Review, use of the term 'evaluation' has contributed to the "erroneous" perception that externally facilitated reviews are intended as a backwards-looking assurance function, whereas the value of such reviews is in informing a continual process of self-improvement for boards. We are not persuaded that there is a substantive difference in the meaning or interpretation of these terms. However, we do not view the use of one term rather than the other as being a big issue – and can therefore live with the use of either.

Q10: Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

We have concerns.

In July 2023, the Government introduced legislation into Parliament which will require all Public Interest Entities (PIEs) to publish a statutorily defined Audit and Assurance Policy (AAP). PIEs are defined as all companies with more than 750 employees and revenue in excess of £750m, regardless of whether they are listed or not[1].

Strictly speaking, premium listed companies that do not fulfil these criteria will not be obliged to publish an AAP. Hence there will be some smaller listed companies that are required to report against the UK Corporate Governance Code but are not legally required to publish an AAP. However, the FRC is proposing that they should nonetheless do so – albeit on the basis of 'comply or explain' rather than as a mandatory requirement.

In our view, the Code should not assume that non-PIEs will necessarily choose to publish an AAP. Although it can be presented to them in the Code as a likely option, we would favour preserving the capacity for boards to exercise their judgement in this matter.

[1] The draft Companies (Strategic Report and Directors' Report) (Amendment) Regulations were laid in Parliament on 19 July 2023. They are subject to debate and approval by the House of Commons and the House of Lords. If approved, they will come into force from the start of 2025.

Hence, we would favour a slight adjustment to the proposed wording of Provision 26. It currently states that one of the main roles and responsibilities of the audit committee is the "developing, implementing, and maintaining the audit and assurance policy".

We would prefer a wording along the lines of: "developing, implementing, and maintaining an audit and assurance policy where applicable".

Q11: Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

We have concerns.

The Standard was published by the FRC in May 2023 following a recommendation from the Competition & Markets Authority that the FRC "should have the power and a requirement to mandate minimum standards for both the appointment and oversight of auditors".

Currently, it applies to the audit committees of all FTSE 350 companies. However, the new wording in the Code is effectively recommending that non-FTSE 350 companies should also apply the Standard, albeit on a 'comply or explain' rather than a mandatory basis.

Specifically, provision 26 states that one of the main roles and responsibilities of the audit committee is that of '*following the Audit Committees and the External Audit: Minimum Standard*'.

As stated in our earlier response, we do not believe that the Code should assume that the boards of companies sitting outside the scope of mandatory regulatory requirements will necessarily wish to apply those requirements. Their capacity to form their own judgements regarding the best interests of the company should be respected.

Hence, we would prefer wording which reflects their continued discretion over this matter, such as the following:

'The main roles and responsibilities of the audit committee should include: following the Audit Committees and the External Audit: Minimum Standard, where applicable.'

If we recognise that some premium listed companies may choose not to apply the Minimum Standard, then it is inappropriate to have removed some key aspects of the governance of external audit from the Code. We should not expect companies that are not choosing to apply the Minimum Standard to still have to refer to it. That would increase the complexity of the regulatory framework rather than reduce it.

Q12: Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

We have concerns.

According to the consultation document, the FRC has decided that the Code should not mandate the establishment of sustainability committees because "companies are building experience in different ways [in relation to sustainability and ESG]".

After such a recognition that boards may choose to pursue diverse ways to organise their ESG and sustainability-related activities, we found it somewhat paradoxical that the Code should be so prescriptive about which committee should be responsible for ESG disclosures, controls, processes, and assurance – namely, the audit committee.

We recognise that, in many cases, the audit committee may be judged by the board to be the appropriate forum through which to oversee these matters. But the Code should not assume that this is the case. In some cases, a sustainability committee, an ESG committee or various other committees may be seen as more appropriate mechanisms through which the board can drill-down into these areas. We do not believe that the Code should seek to embed a too rigid framework for how the board should organise its activities.

In addition, we are concerned that the Code may be piling too many important responsibilities onto one committee – the audit committee – with the consequence (perhaps unintended) that audit committees become seen as a separate seat of governance authority. This would dilute the collective responsibility of the unitary board, and undermine the principle that board committees exist to support boards.

In our view, the scope of responsibilities for the audit committee defined in the Code should remain more or less as before. Responsibility for corporate reporting in its broadest sense (including ESG, narrative and sustainability reporting) and for the oversight of risk management and internal control should be clearly labelled as the responsibility of the board as a whole, with flexibility for it to assign detailed consideration of these issues to specific committees as they judge appropriate.

Q13: Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

We have concerns.

We agree with the Government's decision not to require mandatory external assurance of risk management and internal control systems – as this is a decision best left to the board.

However, we also appreciate that the Government wishes to emphasize to boards that they must assume full ownership of these areas. Hence the proposal for the Code to recommend an explicit directors' statement about the effectiveness of the company's internal controls and risk management. Given the deficits in governance observed in several recent corporate collapses, this is an understandable demand.

We would observe that most responsible directors are well aware of their responsibilities in these areas. However, the current lack of substantive information in annual reports about risk management and internal control – and the work carried out during the reporting period to maintain their effectiveness – is probably not helpful to the building of stakeholder trust.

Hence, we are agreement with the addition of the following new wording to provision 30 of the Code:

The board should provide in the annual report:

A declaration of whether the board can reasonably conclude that the company's risk management and internal control systems have been effective throughout the reporting period and up to the date of the annual report;

An explanation of the basis for its declaration, including how it has monitored and reviewed the effectiveness of these systems; and

A description of any material weaknesses or failures identified and the remedial action being taken, and over what timeframe.

However, we wish to emphasize that an excessive amount of operational detail should not be required in these disclosures. Stakeholders (including investors) are mainly concerned with gaining a sense of reassurance that the board is properly addressing risk management and internal control, and is equipped to deal with any problems. They are not well-placed to second-guess the board's detailed oversight of these areas, and it would be counterproductive to encourage them to do so.

Furthermore, any disclosure of specific risk management or control issues should only highlight matters which are highly material to the company's overall performance or continued viability. We note that what constitutes a 'material weakness' will be clarified in revised guidance, and have a suggestion for that (see below).

Q14: Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

We agree.

We agree that it should be based on continuous monitoring, reflecting the fact that risk assessment is a continuous and dynamic process rather than a one-off exercise during the year.

Q15: Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

We agree.

We are in agreement that company reporting should be conceptualised in a broader sense that purely 'financial' reporting. Hence, we agree with this change.

Q16: To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

We agree.

It seems reasonable to set out examples of this nature in the guidance to the Code, albeit while avoiding prescriptiveness.

Q17: Do you have any proposals regarding the definitional issues, e.g. what constitutes an effective risk management and internal controls system or a material weakness?

We have concerns.

In order to emphasize that 'material weaknesses, would only be expected to be reported on if they are highly significant, we suggest that the current definition under consideration be amended to the following (our changes are underlined):

"A <u>substantial</u> fault, deficiency or failure in the design or operation of the risk management and internal control framework, such that there is a reasonable possibility that the company's

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ability to identify, assess, respond to or monitor key risks to its strategic, operational, reporting and compliance objectives is adversely affected to a significant extent".

Q18: Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

We agree.

We have nothing to add.

Q19: Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

We agree.

We agree with this approach.

Q20: Do you agree that all Code companies should continue to report on their future prospects?

We agree.

We agree that they should do so, as such a recommendation is already part of the Code.

Q21: Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

We agree.

Q22: Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

We agree.

We support the changes to section 5, which include emphasizing the importance of transparency when setting executive pay and its link to long-term sustainable success. We

also support the need for remuneration outcomes being clearly aligned to company performance, purpose, and values, and the achievement of sustainability/ ESG objectives. The reference to workforce pay and conditions as a factor which remuneration committees should have regard to is also something that we would agree with.

Q23: Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

We agree.

One of the most important proposed changes to the Code is that contained in provision 39: that '*director contracts and/or other agreements or documents which cover director remuneration should include malus and clawback*.' We support this new wording.

If malus and clawback are to be effective tools of governance, it is essential that they are incorporated into employment and/or appointment contracts. Without this change, it will be difficult to enforce malus and clawback at the crucial moment, e.g. in the wake of a corporate collapse or when misconduct has been identified. Such an inability to respond to poor director conduct has adverse reputational consequences for business as a whole, and creates a sense that individuals are being rewarded for failure.

Q24: Do you agree with the proposed changes to Provisions 40 and 41?

We agree.

The proposed new wording includes the following:

The annual report on remuneration should include a description of its malus and clawback provisions, including:

- *the minimum circumstances in which malus and clawback provisions could be used.*
- *a description of the minimum period for malus and clawback and why the selected period is best suited to the organisation; and*
- *whether the provisions have been used in the last reporting period. If provisions have been used, a clear explanation of the reason should be provided in the annual report.*

Companies should set out the use of their malus and clawback provisions in the last five years.

We support these changes, as we feel they will enhance the credibility of executive pay arrangements.

Q25: Should the reference to pay gaps and pay ratios be removed, or strengthened?

We agree.

We agree that the reference to pay ratios and pay gaps would create duplication, given that reporting on these metrics occurs elsewhere in the annual report.

Q26: Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

We agree.

We would anticipate that future editions of the Code will need to address the impact of technological developments, such as AI, on the functioning of the board in a more explicit manner. At the current time, it would be useful if the Code guidance could refer directors to sources of best practice in this area, such as the IoD's recent publication: 'AI in the Boardroom The essential questions for your next board meeting'.

IoD

Appendix: Results of IoD Member Survey

This Policy Voice member survey took place between in the second half of July 2023. 876 IoD members responded to the survey.

The survey did not attempt to address all of the detailed changes proposed for the Code. Rather, it seeks to understand IoD member attitudes in relation to some of the broad issues being tackled.

As well as the statistical results, we also present a representative collection of some of the comments that we received. We also provide more general member perspectives on corporate governance regulation.

It should be noted that many of the members responding to the survey are not directors of premium listed companies. Rather their responses should be seen as representative of the attitudes of the UK business community as a whole, including SMEs and unlisted enterprises.

1) When reporting on company strategy, do you think that boards should always be required to report on the company's climate ambitions and transition planning towards net zero?

No, this should be a matter for each board to decide	51.2%
Yes, this should always be provided	47.3%
Don't know	1.5%

Member comments:

- “Boards need to take a long-term view as to how they respond to the net zero target. Boards need to concentrate on the issues needed to operate both responsibly and profitably, without having to slavishly follow the latest political grandstanding fashion.”
- “The climate reporting should be obligatory but not onerous or prescriptive, as all companies are different.”
- “Boards and companies need to be more transparent than ever, and climate goals are critical.”
- “Regarding reporting on climate ambitions: for companies in scope of the Code: yes, this makes sense. Though they should retain substantial freedom to determine their goals/targets, different companies may rightly have different emphasis.”

2) Do you think that annual reports should have to include more information on directors' external time commitments with other organisations and how they manage these?

No, boards and directors should decide how much information is reported	59.0%
Yes, more information should always be provided	39.1%
Don't know	1.9%

Member comments:

- "With regard to director's external time commitments these should be reported where they have the potential to be perceived as causing a conflict of interest."
- "I think it would be unwise and potentially time-consuming/onerous to require detailed explanation of individual directors' time commitments. However, the board's policy on this topic should be shared. Details of individuals should be a matter for the board. Conflict of interest management is probably more important; the board should be required to publish their policy for that and annual report on compliance/management."

3) With respect to board and senior management positions, should the Code give equal weight to all diversity characteristics - to encourage companies to consider diversity beyond gender and ethnicity?

No, the board should determine its own priorities with regard to diversity and inclusion	53.1%
No, the focus should be on improving diversity with regard to gender and ethnicity	13.7%
Yes	30.7%
Don't know	2.5%

Member comments:

- "Diversity and inclusion are not straightforward. I believe it is more important to demonstrate an impartial/unbiased process for talent management and board composition over fixed targets. We need the right skill, knowledge and mindset mix."
- "Diversity approaches and 'requirements', often driven by social media pressure, have meant that positions have not always been filled by the best candidate. This is not what the law expects and is a major impact on other staff, particularly those line managers that are trying to recruit. It seems companies are afraid to speak out about this in case they get media kickback."

- "As a director with a physical disability, I believe we have much to offer. We face different challenges (and provide opportunities for the organisation to learn from us). This broadens perspectives."
- "EDI and ESG should not be forced on any company, of any size or shape. The role of businesses is to make money; not to virtue signal."

4) Is it reasonable to expect directors to have to disclose any weaknesses or failures in internal control and risk management systems in their annual report?

No, it's a matter for the board to determine if this information should be disclosed	47.4%
Yes, this should always be provided	48.9%
Don't know	3.6%

Member comments:

- "Disclosure of all these matters can be bland and not really convey the true essence of the situation; similarly, disclosure of everything will lead to extremely lengthy reports so a proper understanding of what is material for the Board and their investors is essential."
- "We should disclose material weaknesses in controls, not any and all weaknesses."
- "There is a current obsession with washing dirty linen in public. Every company has issues, but reporting on them constantly can lead to giving an unhelpful view of a company's actual health. The Directors should be held accountable for performance, but it should remain for them to decide what to disclose publicly. "
- "The need to disclose focuses the mind - too often directors are not held accountable."
- "Disclosure on internal controls and risk management is a difficult one as it can have a commercial impact that is disproportionate to the actual level of risk. However, against this you have to balance the risk that Boards will downplay concerns or issues that do have a potential impact to the wider stakeholders of that business or organisation. "
- "Well managed businesses should be constantly reviewing weaknesses and failures and set about correcting them. (But) Disclosing such information may cause difficulties to certain employees or departments. There may also be added advantage to competitors, by disclosing weaknesses, before they can be corrected."

5) Should directors' contracts always include provisions that would enable the company to recover and/or withhold sums or share awards in cases of subsequent misconduct or wrongdoing?

No, the contents of directors' contracts should be a matter for boards and directors to determine	30.3%
Yes, such provisions should always be included in directors' contracts	67.0%
Don't know	2.6%

Member comments:

- "There are too many examples of corporate bonuses being given/taken while the same companies are almost on the edge of bankruptcy and riddled with incompetence."
- "It's a very dangerous game to suggest that companies can recover sums or share awards as these might be entirely subjective and could be used as a punishment or deliberate abuse of power."
- "Whilst it (clawback) should be available, the bear trap is directors making decisions in good faith and with information at the time and then being held to account for changes that only hindsight indicates were poor decisions."
- "An incentive to gain a bonus through rule breaking is a bad idea, so the clawback option must be there."
- "I can see benefits to this (clawbacks) in terms of encouraging integrity and longer-term perspectives, but care would be needed to ensure it is not overly onerous, open to abuse, or excessively long-winded. "

6) General perspectives from IoD members on corporate governance regulation

- "It is vitally important that we don't squeeze innovation and entrepreneurship with more rules and regulations especially those that are akin to current fads rather than meaningful long-term strategy."
- "Corporate transparency is an absolute fundamental of good business in the 21st century; a statement of values is meaningless without authentic and visible leadership by the Board."
- "Annual Reports for listed companies have now become absolute monsters - I seriously do not believe that any more than a handful of shareholders read them all the way through - effort is needed to reduce their length, significantly."
- "There already is a huge reporting burden on companies. I question how many people read the reports and whether the cost of preparing all this data is less than the overall benefit it provides. I would welcome a push to reduce the reporting burden on companies and to make sure the reporting that remains really adds value to society and is easy to understand by the general public rather than the current technical tick box regime that is way too complicated for the average person to understand and in reality, is very rarely read by anyone."

- “I believe in strong guidance and definition of best practice rather than mandating behaviour, because one size never fits all.”
- “The system has become over complicated and thus impossible to monitor and police. Perhaps it should be mandatory for all company directors to undertake a course on corporate governance?”
- “We no longer invest in UK as boards don’t care about what matters to owners.”
- “We must strike a balance between the need for better corporate governance and an overbearing police state style of regulations that will consume too much time and smother us with needless bureaucracy.”
- “After recent corporate scandals such as Carillon and others, business needs to put emphasis on tidying its own reputation - without that effort, regulation will be required to tighten up on poor practices and ill-thought-out actions. The current guidance is rapidly becoming out of date and urgently needs refreshment for today's post-Covid, climate driven environment.”
- “There is a real need to consider very fully the impact on the choices capable and experienced directors will make if the risks and penalties to them exceed the rewards of holding their responsibilities. These are people too and their experience and skill are vital to the good guidance and governance of good companies, each of which is different and unique.”
- “Our UK economy is fragile. The Government should refrain from putting yet more controls on private business. It’s not helpful and crippling to our economy.”

With kind regards,

R. Barker

Dr. Roger Barker
Director of Policy and Corporate Governance