



The New UK Corporate Governance Code

- The new UK Corporate Governance Code, (previously the Combined Code), was published on 28 May and will apply to financial years commencing on or after 29 June 2010. See the FRC website at www.frc.org.uk/corporate/ukcgcode.cfm
- The Code will apply to Premium Listed companies, including those registered outside the UK
- For FTSE 350 companies a new provision relates to annual re-election of all board members
- Board evaluation should be externally facilitated at least every 3 years for FTSE 350 companies
- Boards are asked to have due regard to diversity on the board, including gender
- Chairmen are encouraged to report personally in their annual statements on how the principles relating to the role and effectiveness of the board have been applied.
- The board should determine the nature and extent of significant risks it is prepared to take and the company's business model should be explained in the accounts. The reference in the consultation document to 'risk appetite' has been dropped as it seems this was poorly understood
- New measures on remuneration link performance-related pay to long-term issues and provide for 'clawback' of incentives in certain circumstances
- There is more focus on getting the right people on the board (including the provision to have due regard to diversity) and on directors spending the appropriate time on their board duties, being better briefed and trained and engaging constructively in debate
- The FRC has focussed on changing the 'tone' of the Code to underline the importance of general principles which it hopes will guide board behaviours. Structural changes have been made to the Code to give more prominence to some of the factors that underpin an effective board (board leadership, the role of the chairman)
- The FRC aims to publish the new Stewardship Code for institutional investors by the end of June

Summary of the Main Changes

The responsibilities of the chairman and directors

- A new main principle on the role of the chairman (A.3) states specifically that the chairman is responsible for the leadership and effectiveness of the board
- An amended supporting principle states the chairman's responsibility for ensuring that adequate time is available (at board meetings) for discussion of all agenda items, in particular strategic issues (A.3)
- An amended supporting principle states that the chairman should promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors (A.3)
- A new principle states that NEDs should 'constructively challenge' and help develop proposals on strategy (A.4)
- The provision on the role of the senior independent director ('SID') has been amended to reflect Sir David Walker's recommendation that the SID should act as a sounding board for the chairman and serve as an intermediary for other directors where necessary (A.4.1)
- A new main principle states that directors should allocate sufficient time to discharge their responsibilities effectively (B.3).

Board balance and composition

- A new principle stresses the need for the board and its committees to have an appropriate balance of skills, experience, independence and knowledge of the company to discharge their duties and responsibilities effectively (B.1)
- New wording in a supporting principle states that the search for board candidates should be conducted and appointments made on merit against objective criteria and 'with due regard to the benefits of diversity to the board, including gender' (B.2)
- A new provision provides that all directors of FTSE 350 companies should be re-elected annually. (B.7.1)

Board information, development and support

- A new supporting principle has been added stating the need for all directors to have appropriate knowledge of the company and access to its operations and staff (B.4)
- A re-worded provision states that directors should avail themselves of opportunities to meet major shareholders (B.4.1). This is stronger than the previous provision that the company should offer major shareholders the opportunity to meet new NEDS
- A new provision has been added that the chairman should regularly review and agree with each director their training and development needs (B.4.2)

Board evaluation

- A new provision states that board evaluation of FTSE 350 companies should be 'externally facilitated' at least every three years. A statement should be made available of whether the external facilitator has any other connection with the company (B.6.2)

Accountability

- A new provision states that directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company (C.1.2)

Risk management and internal control

- An amended principle on risk management and internal control states the board's responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. It also states that the board should maintain sound risk management and internal control systems (C.2)
- The previous provision on the board's annual review of the effectiveness of internal controls has been expanded to extend the review to risk management (C.2.1)
- The FRC will carry out a limited review of the Turnbull guidance during this year on which there will be a separate consultation

Remuneration

- A new supporting principle has been added on the need for the performance related elements of directors' remuneration to be stretching and designed to promote the long-term success of the company (D.1)

- The provision on remuneration of NEDs has been amended to clarify that all forms of performance-related remuneration are discouraged for them and not just share options. It also specifies that if, exceptionally, options are granted they should be subject to prior shareholder approval and any shares resulting from their exercise should be held until at least a year after the NED leaves the board. (D.1.3.)

The remuneration schedule (Schedule A) has been amended to state that

- performance conditions for directors' annual bonuses should be designed to 'promote the long-term success of the company'
- executive share options should not be offered at a discount (except as permitted by the Listing Rules)
- all incentive schemes should be subject to challenging performance criteria reflecting the company's objectives 'including non-financial performance metrics where appropriate'
- incentives should be 'compatible with risk policies and systems'
- consideration should be given to re-claiming variable components 'in exceptional circumstances of misstatement or misconduct' (clawback)

Relations with shareholders

- The supporting principle on understanding shareholder issues and concerns is now stronger as it requires the chairman to 'ensure that all directors are made aware of their major shareholders' issues and concerns' (E.1)

Engagement of Institutional Shareholders

- Schedule C – 'Engagement Principles for Institutional Shareholders' - previously Section 2 – has not been changed but the intention is to delete it once the new Stewardship Code comes into force.

Points you may want to consider

Although the Code operates on a 'comply or explain' basis and relatively few changes of substance have been made to it, you may wish to consider taking action on these points:

The chairman and directors

- Should you review the time commitment of your chairman and NEDs – now and for the future? Will you need to make any changes to your appointment procedures and letters of appointment?
- Should your directors take on external directorships? If so, what type of role would generally be permissible and how many?
- Should you consider whether your board really has a culture of open debate? What could be done to encourage this?
- Are you satisfied that your board devotes enough time to debating strategy? Is there enough time on the agenda for debate? Are your NEDs engaging to help develop strategy?
- Is participation encouraged from all directors? Does the board debate in a spirit of 'constructive challenge?' What more could be done to promote this?
- NEDs need to avoid straying too far into management territory, but executives should generally be open to NEDs' challenge. Have you got the balance right here? Is there an acceptance that it is part of the NEDs' role to challenge?
- Do you agree the SID should act as the chairman's sounding board? What about other directors? Will you take any steps to implement this Code change?

Information and professional development

- How do you ensure all directors have appropriate knowledge of the company - and access to operations and staff?
- Proper information and support is needed for debate to be meaningful – how do you achieve this? Do changes need to be made?
- What will you do to ensure directors can avail themselves of opportunities to meet major shareholders?

Board balance and composition

- Will you review board balance and make any changes? Will this affect your succession planning?

- And your recruitment procedures? How will you ensure search consultants are briefed to take account of the new provisions, especially on recruitment on merit and having due regard to diversity?
- If you are a FTSE 350 company, will you put forward your directors for re-election annually?
- Does your board have a policy on diversity? How will it have 'due regard' to diversity issues?

Board evaluation

- If you have not carried out board evaluation will you now plan to do so? If you are a FTSE 350 company will you move to a policy of 'external' evaluation at least every third year?
- How do you interpret 'externally facilitated'? Would you move to a 'hybrid' approach – using both internal and external resources?
- For external evaluations, will the new 'conflict' wording affect your choice of provider? What categories of provider might you avoid?

Remuneration

- Are performance-related elements of directors' remuneration designed to promote the long-term success of the company? Do they need to be reviewed?
- Is it appropriate for your company to include non-financial metrics in performance criteria for your incentive schemes?
- Are your incentives compatible with your risk policies?
- What is your view on clawback? Have you considered it? How would it work in practice?

Risk management

- The Code says the board should determine the nature and extent of the risks it is prepared to accept. How often does your board debate this and how do you go about deciding which types of risk are acceptable?
- How does the board ensure that it maintains a sound risk management system? Do you have clear processes for embedding this throughout the business? Are you satisfied with the report back from the business?

Corporate reporting

- Consider including a chairman's personal statement in the annual report on how the board effectiveness principles of the Code have been applied
- The Code asks you to include information on the business model and your strategy in the annual report. How will this be achieved?

- Are there other areas of the annual report where you might want to make changes to your reporting to reflect your approach to the new Code?
- Where you choose to 'explain' against the Code, do you have a well thought through explanation of what you have decided to do which you can easily explain to shareholders and describe in your annual report? How are you going to engage with shareholders to explain any major departures from the Code?

To discuss any aspect of this note, or other governance-related issues, please contact Julia Casson or Ken Rushton at Board Insight

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