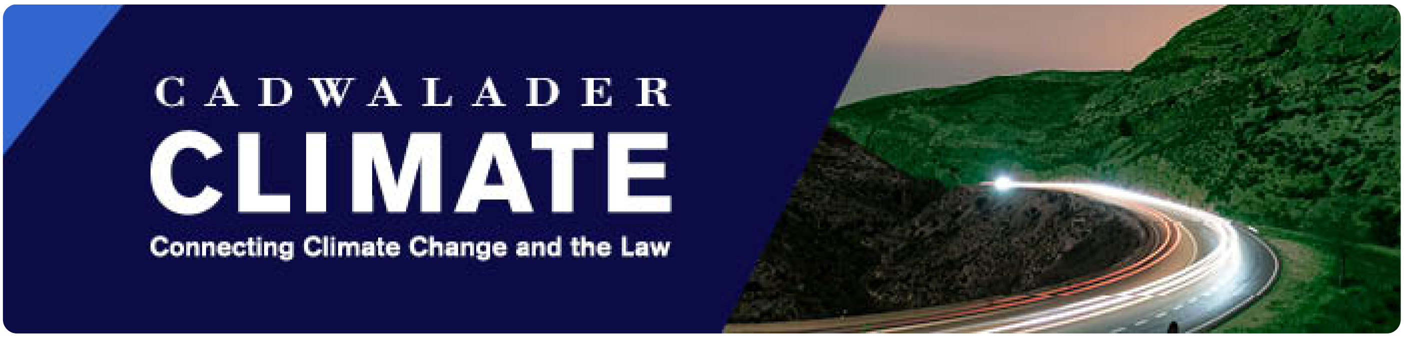
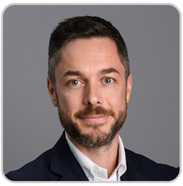
CADWALADER



UK Institute of Directors: UK's FRC Should Maximize Adaptability of Governance Code

November 7, 2023



By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

By Sharon Takhar
Associate | White Collar Defense and Investigations

In September 2023, the UK's Institute of Directors (IoD) announced its broad support for changes to the UK Corporate Governance Code proposed by the Financial Reporting Council (FRC). The FRC's proposed revisions seek to improve internal controls, internal and external assurance, and ESG reporting. In addition, the proposals discuss the role of audit committees and executive pay. The revised Code would be applicable to accounting years beginning on January 1, 2025.

The IoD opinion can be found in two documents: its **response** to the FRC consultation and its recent policy paper, **"Are Boards Losing Control?"** In the IoD's view, the proposed reforms are useful, but do not go as far as the sweeping reforms made in 2018, which resulted in the implementation of the existing Corporate Governance Code.

Complying with the UK Corporate Governance Code is required for approximately 900 companies—those with a premium listing on the London Stock Exchange. The Code is principles-based; more prescriptive recommendations are contained in additional provisions. Companies are expected to apply the Code's principles in their reporting, though this varies considerably by company, as the Code employs a "comply or explain" model in which companies can delineate their reasoning in not complying with any provisions.

While generally supportive of proposed changes to the Code, the IoD lists a few key caveats. The IoD believes that boards are better suited than regulators to promote the best interest of their companies, so it took issue with some of the more explicit directions for boards. The IoD also concluded that the Code was not a deterrent for companies in deciding whether to list in the UK, but stressed that the FRC should highlight the adaptability of the Code, in order to avoid seeming overly prescriptive. In particular, the IoD flagged the “comply or explain” provisions, stressing that this is the Code’s key selling point.

An area that the IoD highlighted in particular was a recommendation that audit committees be primarily responsible for ESG disclosures, control, processes and assurance, noting that not all audit committees enjoy similar capabilities or expertise on the part of committee members, and many may already have a full portfolio within their mandates. For some firms, the audit committee may not even be the appropriate body, but rather, for certain companies an ESG-specific committee would be better suited, or the entirety of the board.

The IoD also addressed the increasing reporting and disclosure requirements placed on companies. The IoD stressed that the Code should minimize this burden whenever possible: reporting ought to provide a value-add for stakeholders.

Finally, the IoD expressed its support for the FRC’s effort to strengthen the Code’s provisions with respect to executive pay. The object of the FRC’s revision in this area is to facilitate a transparency and foster an environment where executives are not rewarded for poor decision-making (whether misconduct or significant financial underperformance). The IoD supported increased information on clawback provisions, including express clawback provisions in employment contracts.

Taking the Temperature: As we have reported, there is strong support for mandatory, standardized ESG reporting in the UK, including the desire to align with EU efforts with the goal of achieving something approaching uniformity in reporting frameworks. Concerns remain, however, about the costs and burdens associated with reporting requirements, and the consequent impact on the UK’s competitiveness in attracting capital and company listings.