Introduction to UK Corporate Governance Code

LP Learn Material

The UK Corporate Governance Code

The Financial Reporting Council (**FRC**) administers the UK Corporate Governance Code (**UKCG Code**). The purpose of corporate governance is to facilitate the effective, entrepreneurial and prudent management of a company, which can deliver its long-term success.

UK Corporate Governance Code 2012

The UKCG Code sets out standards of good practice in relation to leadership and effectiveness of the board of directors, remuneration, accountability and relations with shareholders. It is based on the underlying principles of all good governance:

- accountability
- transparency
- probity, and
- the need to focus on the sustainable success of an entity over the longer term

Application

The UKCG Code applies to **listed companies**, which for the purpose of this note means:

- UK companies (as defined) with a premium listing (as defined) in the UK of equity shares (as defined), and

  Financial Conduct Authority Handbook, Glossary, definitions of company, premium listing and equity shares for the Listing Rules
- overseas companies (as defined) with a premium listing in the UK of equity shares

  FCA Handbook, Glossary, definition of overseas company for the Listing Rules

The current version of the UKCG Code was issued in September 2012 and applies to companies with accounting periods beginning on or after 1 October 2012.

The previous version of the UKCG Code was issued in June 2010 and will continue to apply for a transitional period to companies that are still within accounting periods beginning prior to 1 October 2012.

The Combined Code was the predecessor to the UKCG Code. It is no longer applicable (it applied to companies with financial years beginning before 29 June 2010).

It is important to note that even companies that are not required to comply with the UKCG Code (eg, a company with a standard rather than premium listing or an AIM company (as defined)) sometimes choose to adhere to certain of its principles and provisions in the interests of best practice.

Principles and provisions

The UKCG Code is not a rigid set of rules but consists of main principles, supporting principles and provisions. The principles are the core of the UKCG Code and the way that they are applied should be the central question for a board as it determines how it is to operate according to the UKCG Code.

UKCG Code 2012

The UKCG Code provisions associated with each principle provide best practice examples of the ways in which a company can apply (and be seen to be applying) those principles.

The UKCG Code is divided into five sections:

- Section A: Leadership, dealing with the role of the board, chairman, the chief executive officer (the **CEO**) and non-executive directors (**NEDs**)
- Section B: Effectiveness, dealing with board composition, board appointments, independence of NEDs, directors' time commitments, induction and continuous development, board evaluations and support
- Section C: Accountability, dealing with financial reporting, internal control and risk management
- Section D: Remuneration, dealing principally with the remuneration of executive directors and the principles to be applied by remuneration committees, and
- Section E: Relations with Shareholders, dealing with constructive engagement with shareholders and the annual general meeting (the **AGM**)

Compliance and reporting

The 'comply or explain' approach underlies corporate governance in the UK. Under the Listing Rules of the Financial Conduct Authority (**FCA**), a company with a premium listing of equity shares must include in its annual financial report:

- a statement of how it has applied the main principles of the UKCG Code, in a manner that enables shareholders to evaluate how they have been applied,
- a statement as to whether or not the listed company has complied throughout the accounting period with all relevant Code provisions, setting out the provisions, if any, it has not complied with, the period of non-compliance and the company's reasons for non-compliance

It is recognised that departures from the UKCG Code provisions may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for those departures should be explained clearly and carefully to shareholders, who may wish to discuss the position with the company and whose voting intentions may be influenced as a result.

Shareholder engagement

Shareholders are expected to respond to a company's statements in a manner that supports the 'comply or explain' process and are encouraged to pay due regard to a company's individual circumstances in relation to any departures from the UKCG Code. Whilst shareholders have every right to challenge companies' explanations if they are unconvincing, they should not automatically treat such departures as breaches of the

UK Stewardship Code

In July 2010, the FRC published the UK Stewardship Code. It was subsequently updated in September 2012 and the updated version applies from 1 October 2012. The UK Stewardship Code supplements the UKCG Code and aims to enhance the quality of engagement between institutional investors and companies. It is thought that this, in turn, will help to improve long-term returns to shareholders and the result in the efficient exercise of governance responsibilities.

Like the UKCG Code, the UK Stewardship Code is applied on a 'comply or explain' basis. Although institutional investors are not obliged to comply with the UK Stewardship Code, they are strongly encouraged to report on how they have complied with it or explain why they have chosen not to comply.

Voting advisory services

Most institutional shareholders and many overseas investors subscribe to at least one corporate governance voting advisory service, such as:

- the Association of British Insurers (**ABI**)
- the National Association of Pension Funds (**NAPF**), and
- Pension Investment Research Consultants Ltd (**PIRC**)

In addition to complying with the UKCG Code, the directors of a listed company should ensure that they are aware of the recommendations of the relevant institutional investor bodies in relation to their corporate governance practices and procedures.

Corporate governance statement

As noted above, the Listing Rules (LR) require that a company include in its annual financial report:

- a statement of how it has applied the main principles of the UKCG Code, in a manner that enables shareholders to evaluate how they have been applied, and
  References: LR 9.8.6(5) R
- a statement as to whether or not the listed company has complied throughout the accounting period with all relevant Code provisions, setting out the provisions, if any, it has not complied with, the period of non-compliance and the company's reasons for non-compliance
  References: LR 9.8.6(6) R

The Disclosure Rules and Transparency Rules (the **DTRs**) also require that an issuer (as defined) includes a corporate governance statement within its directors' report which must contain, among other information, details on the corporate governance codes applicable to the company and how the company has complied with such codes. A company which complies with LR 9.8.6 R in relation to the UK will be deemed to have complied with the certain content requirements of the corporate governance statement required under the DTRs.
References: The Disclosure Rules and Transparency Rules, DTR 7.2

A company which has a class of its shares listed, but not a premium listing, is also required to report on its compliance within a corporate governance statement in its directors report in accordance with the Disclosure Rules and Transparency Rules of the FCA.
References: LR 14.3.24 R

DTR 7.2

A listed company's corporate governance statements must be reviewed by its auditors before publication, but only in so far as it relates to certain UKCG Code provisions.
References: LR 9.8.10 R

Committees of the board

The UKCG Code makes various recommendations for the establishment of the following committees to regulate and monitor different aspects of corporate governance of the company:

UKCG Code 2012

- the audit committee
- the remuneration committee
- the nomination committee, and
- where applicable, the risk committee

The UKCG Code also requires boards of listed companies to establish a formal schedule of matters specifically reserved for their decision.

UKCG Code 2012, provision A.1.1

Making documents and information available

The UKCG Code requires certain documents and information to be made publicly available, including:

- the terms of reference of the nomination committee
  References: UKCG Code 2010, provision B.2.1

  UKCG Code 2012, provision B.2.1
- the terms and conditions of appointment of non-executive directors to be made available for inspection by any person at the company's registered office during normal business hours and at the annual general meeting (for 15 minutes prior to the meeting and during the meeting)
  References: UKCG Code 2010, provision B.3.2

  UKCG Code 2012, provision B.3.2
- the terms of reference of the remuneration committee
  References: UKCG Code 2010, provision D.2.1

  UKCG Code 2012, provision D.2.1
- where remuneration consultants are appointed, a statement as to whether they have any other connection with the company
  References: UKCG Code 2010, provision D.2.1

  UKCG Code 2012, provision D.2.1
- the terms of reference of the audit committee, and
  References: UKCG Code 2010, provision C.3.3

  UKCG Code 2012, provision C.3.3
- if applicable, the terms of the risk committee
  References: ICSA Model Terms of Reference--Risk Committee

Except in relation to the terms of appointment of non-executives, the UKCG Code provides that the above requirements may be met by publication on the company's website.
References: UKCG Code 2010, footnote 7

UKCG Code 2012, footnote 7

The UKCG Code also requires that information about each committee of the board should be disclosed in the company's annual reports.

Corporate governance codes for particular types of company

Certain provisions or additional regulations may apply or not apply to particular types of company:

Smaller listed companies

A 'smaller listed company' is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. The UKCG Code provides that smaller listed companies may judge that some of the provisions are disproportionate or less relevant in their case.
References: UKCG Code 2010, footnote 6

UKCG Code 2012, footnote 6

The following provisions of the UKCG Code only apply to companies within the FTSE 350 and are not obligatory for smaller companies (although smaller companies may still choose to comply with such provisions):.

- the board of FTSE 350 companies should be evaluated by an external facilitator at least every three years
  References: UKCG Code 2010, provision B.6.2

  UKCG Code 2012, provision B.6.2
- all directors of FTSE 350 companies should be subject to annual election by shareholders
  References: UKCG Code 2010, provision B.7.1

  UKCG Code 2012, provision B.7.1
- FTSE 350 companies that are subject to the 2012 version of the UKCG Code should put the external audit contract out to tender at least every ten years
  References: UKCG Code 2012, provision C.3.7

Investment companies

If a listed company is an investment company, it also should refer to the Association of Investment Companies' (**AIC**) Code Corporate Governance in addition to the UKCG Code. The FRC have endorsed the AIC's code and have confirmed that those companies that follow and report against the AIC code will be meeting their obligations in relation to the UKCG Code.

Smaller quoted companies

Smaller quoted companies, AIM companies (as defined) and companies with securities that are listed on the ISDX Main Board, ISDX Growth Market or ISDX Secondary Market (previously known as PLUS-listed, PLUS-quoted and PLUS-traded) that are not subject to the UKCG Code should instead look to comply with the Quoted Companies Alliance (**QCA**) Corporate Governance Guidelines. These guidelines take account of the UKCG Code, but are specifically focused on the needs of smaller quoted companies.