

WATSON FARLEY & WILLIAMS

BRIEFING

UK CORPORATE GOVERNANCE REFORM: WHAT'S IN THE PIPELINE?

JANUARY 2018

- PROPOSED CORPORATE GOVERNANCE REFORMS WILL AFFECT LARGE PRIVATE AND PUBLIC COMPANIES
- THESE ARE EXPECTED TO COME INTO FORCE BY JUNE 2018



Changes will be made to the UK corporate governance framework following publication in August 2017 of the Government's response to its November 2016 green paper on corporate governance reform in the UK. These will affect large private and public companies and are expected to come into effect by June 2018.

This briefing outlines the proposed changes, which focus on: (i) corporate governance in large private companies; (ii) strengthening the employee, customer and wider stakeholder voice in boardroom decision-making; and (iii) executive pay.

CORPORATE GOVERNANCE IN LARGE PRIVATE COMPANIES

The Government wishes to strengthen the corporate governance regime for the UK's largest private companies as the conduct and governance of these companies has a considerable impact on the interests of employees, suppliers, customers and others in a similar way to public companies. This was particularly evident in the collapse of BHS, where thousands of employees and pensioners suffered. To enhance confidence in big business, large private companies need to show that they are well run, take a responsible approach to corporate governance and show regard for their wider stakeholders.

A voluntary set of corporate governance principles

The Financial Reporting Council ("FRC") is to work with the Institute of Directors, the British Venture Capital Association ("BVCA") and others to develop a voluntary set of corporate governance principles for large private companies. Companies will continue to be able to use other industry-developed codes and guidance, such as

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“NEW LEGISLATION WILL REQUIRE UK INCORPORATED COMPANIES OF A SIGNIFICANT SIZE (PUBLIC AND PRIVATE) TO DISCLOSE THEIR CORPORATE GOVERNANCE ARRANGEMENTS.”

that developed by the BVCA for private equity-owned businesses, if they consider them more appropriate.

New disclosure and reporting requirements

New legislation will require UK incorporated companies of a significant size (public and private) to disclose their corporate governance arrangements, including whether they follow any formal code. Disclosure will be required both in the directors’ report and on a company’s website so that the information is easily accessible to external stakeholders.

The Government’s initial view is that this new requirement should apply to companies with more than 2,000 employees unless they are subject to an existing corporate governance reporting requirement, however this is subject to further review. It may also be extended to large limited liability partnerships (“LLPs”).

STRENGTHENING THE VOICE OF STAKEHOLDERS

The Government wants to improve the way in which UK incorporated companies take account of the views of key corporate stakeholders. It is planning to enhance the current statutory requirement on directors to take account of various specified interests when making decisions (set out below) by introducing a new reporting requirement. The rationale for this is to make directors think more carefully about how they take these matters into account, create more transparency and provide a level of assurance that the long-term sustainability of a company is a key component of its management.

CURRENT STATUTORY REQUIREMENT

Under section 172 of the Companies Act 2006 (“section 172”), which applies to all UK incorporated companies irrespective of size, a director must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so a director must take into account a non-exhaustive list of factors:

1. the likely consequences of any decision in the long term;
2. the interests of the company’s employees;
3. the need to foster the company’s business relationships with suppliers, customers and others;
4. the impact of the company’s operations on the community and the environment;
5. the desirability of the company maintaining a reputation for high standards of business conduct; and
6. the need to act fairly as between members of the company.

New reporting requirement and guidance

New legislation will require UK incorporated companies of a significant size (public and private) to explain how their directors comply with the section 172 requirements in relation to employee and other interests. Disclosure may need to be made on a company’s website as well as in the company’s strategic report. For this requirement, the initial view is that the threshold should be 1,000 employees, however this is subject to further review.

To assist with compliance with section 172, the GC 100 group of the largest listed FTSE 100 companies will produce guidance on the practical interpretation of the duty in section 172.

“THE GOVERNMENT PROPOSES TO TAKE STEPS TO HOLD EXECUTIVES OF PREMIUM LISTED COMPANIES TO ACCOUNT OVER PAY IN RESPONSE TO A CONTINUING WIDESPREAD PERCEPTION THAT BOARDROOM REMUNERATION IS INCREASINGLY DISCONNECTED FROM THE PAY OF ORDINARY WORKING PEOPLE.”

Changes to the UK Corporate Governance Code and industry guidance

For premium listed companies (those that have a premium listing of equity shares) the Government intends to go further. In its consultation published on 5 December 2017, the FRC is consulting on the development of a new principle in the UK Corporate Governance Code (the “Code”) which stresses the importance of taking into account the interests of employees and other non-shareholders at board level. It is also consulting on a specific provision which requires premium listed companies to adopt, on a “comply or explain” basis, one of three employee engagement mechanisms: a designated non-executive director; a formal employee advisory council; or a director from the workforce. As many smaller quoted companies (such as AIM companies) follow the Quoted Company Alliance’s Corporate Governance Code for Small and Mid-Size Quoted Companies, which adopts key elements of the Code, these new provisions may also become relevant to them.

In September 2017, the Institute of Chartered Secretaries and Administrators and the Investment Association (“IA”) published joint [guidance](#) on practical ways in which companies can engage with their employees and other stakeholders.

EXECUTIVE PAY

The Government proposes to take steps to hold executives of premium listed companies to account over pay in response to a continuing widespread perception that boardroom remuneration is increasingly disconnected from the pay of ordinary working people and has not been matched by long-term company performance. The FRC is consulting on revising the Code to:

- set out the steps that companies should take when faced with significant shareholder opposition to executive pay;
- give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company and include a requirement for chairs of remuneration committees to have served on such a committee for at least a year previously; and
- increase the minimum holding period for share-based remuneration from three to five years.

In addition, the IA has been asked to maintain a public register of premium listed companies encountering shareholder opposition of 20% or more to executive pay and other resolutions, along with records of what these companies say they are doing to address such opposition. The register was launched on 19 December 2017 and at launch included 22% of more than 640 FTSE All-Share companies, due to them having at least one resolution that received over 20% dissent or was withdrawn during 2017. 38% of resolutions on the register at launch were pay-related.

Further reporting requirements will also be introduced to expand the details that must be contained in the annual remuneration reports of UK quoted companies (as that term is defined in the Companies Act 2006, which includes companies included in the Official List but not AIM quoted companies). These will include providing the ratio of CEO pay to the average pay of their UK workforce and a narrative explaining changes to that ratio from year to year and how the ratio relates to pay and conditions across the wider workforce.

“CORPORATE GOVERNANCE REQUIREMENTS FOR ALL COMPANIES ARE LIKELY IN THE LONGER TERM TO BE INFLUENCED BY THE STANDARDS SET FOR LARGER COMPANIES.”

TIMING AND APPLICATION

It is currently intended that the reforms will come into force by June 2018 to apply to company reporting years commencing on or after that date (although the revised Code is expected to apply to company reporting years commencing on or after 1 January 2019).

Companies should familiarise themselves with the changes that may be applicable to them as not all of the proposed changes will affect all types of company. Corporate governance requirements for all companies in the longer term are likely to be influenced by the standards set for larger companies and good corporate governance should be something all companies strive to achieve. Crucially, all companies are subject to the duty in section 172 (whether or not they will be subject to the new reporting obligation) and may find the new guidance helpful in ensuring compliance.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.



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