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27 June 2014

Dear Ms Woods,

FRC – Proposed Revisions to the UK Corporate Governance Code – Consultation Document

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Corporate Governance, Financial Reporting and Share Schemes Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

Response

We welcome the opportunity to respond to this consultation and build on our responses to the previous FRC consultations on Risk Management, Internal Control and Going Concern (January 2014) and on Directors' Remuneration (December 2013).

We generally agree with the proposed revisions of the UK Corporate Governance Code ("the Code"); we have provided some further suggestions on how to improve the wording of the new provisions in places, namely regarding remuneration and risk management and internal controls. We emphasise that the need for clarity is crucial throughout the Code and associated guidance, especially regarding the differences and links between the going concern and the viability statements.

We have provided answers to all questions of the consultation document in detail below.

Responses to specific questions

Q1 Do you agree with the proposed changes in Section D of the Code?

Regarding the proposed changes to 'Section D: Remuneration', we agree with the deletion of the paragraph of the Main Principle in D.1 'The level and components of remuneration' and we welcome the introduction

of the new Main Principle paragraph as drafted. We believe that this change is helpful to create the right emphasis in promoting the success of the company.

Regarding the supporting principle, we believe that the words “and should avoid paying more than is necessary” should be replaced by “and should avoid making excessive rewards”. We believe that the Remuneration Committee should carefully evaluate the risks involved in setting the levels of pay including potential performance-related pay. We consider that there is a potential risk of losing a director if the remuneration is less than necessary. The fact that the balance is difficult to strike – between paying more than is necessary and appropriately rewarding performance – should be acknowledged.

Q2 Do you agree with the proposed changes relating to clawback arrangements?

While we have previously argued (in our response to FRC Directors’ Remuneration Consultation, December 2013) that no amendment to the Code was needed regarding clawback arrangements as investors were already making their views very clear on this (for example, the NAPF/Hermes EOS five principles and the letter sent by Fidelity to investee companies), we believe that the inclusion of the proposed phrasing of D.1.1 on the recovery of sums paid/withholding of payments will clarify the current situation.

However, we consider that this change could raise one potential issue. A company which has approved its policy for directors this year (2014) would have intended to propose a new policy in 2017. The timing of the change would perhaps compel those companies that do not currently include clawback arrangements in their directors’ performance-related remuneration scheme to decide between updating their remuneration policy earlier than the end of the anticipated three-year cycle or explaining to shareholders why they have not complied with this provision of the Code until the remuneration policy is updated. We question whether the FRC has considered the inconvenience this could generate for the companies and investors, particularly given that the GC 100 and Investor Group’s guidance discourages the re-submission of policies more frequently than every three years.

We had supported in our response to the abovementioned consultation that the Government and the FRC should allow the changes to the Companies Act to bed down and then evaluate, after the 2015 AGM season, the cultural change they have elicited in the relationship between companies and their shareholders.

Considering that, and considering the potential issue described above, we believe that the FRC should analyse the possibility of a transitional provision to acknowledge this and time its next cycle of looking at this area so that any changes can be taken into account by companies when they address shareholders in 2017. The FRC should take into consideration that companies that do not have clawback arrangements in place could potentially be without them for a considerable amount of time.

Q3 Do you agree with the proposed change relating to AGM results? Is the intention of the proposed wording sufficiently clear?

In relation to section E.2.2, we generally agree with the introduction of the new paragraph regarding the AGM results. We note that it might be difficult in terms of timing for the board to immediately decide and define “what actions it intends to take to understand the reasons behind the vote result” right after the vote results. For that reason, we consider that this may lead to boilerplate disclosure stating that the

shareholders will be approached as well as other general statements and standard phrasing, which should be avoided.

We believe that the board should be given sufficient time to consider the issue and take advice so that it can respond meaningfully. We would like to underline that quality statements should be encouraged in a timely fashion and that flexibility to delay that statement may perhaps be considered by the FRC.

Q4 Do you agree with the proposed amendments to the Schedule?

We believe that, in line with what was supported above, the first thing that the Remuneration Committee should do is to determine the balance between fixed pay and performance-related pay. We suggest that those words are added at the beginning of the first paragraph of Schedule A.

We do not understand why "Executive options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules" is mentioned in the Code. If the Listing Rules prohibit something, then the Code does not need to repeat this. More importantly, a great number of companies offer nil-cost options now and this suggests that they should not. We believe that this should be removed.

We further believe that the changes introduced in the fourth paragraph may be slightly ahead of the market and that the FRC should be careful about taking the lead on this point. We question whether investors only being "generally supportive" of this practice is a high enough threshold reached for inclusion of the post-vesting period in the Code.

We consider that specific consultation would be necessary for the FRC to put forward these specific remuneration ideas as best practice. Many companies do not want post-vesting holding periods as they claim that if they are pushed into offering them, they will have to pay more, which may be a valid point for the FRC to consider especially regarding small and mid-size quoted companies.

Finally, we would suggest deleting part of the fifth paragraph ("*There may be a case for part payment in shares to be held for a significant period."*), as it is rendered superfluous by the proposed FRC changes to the fourth paragraph regarding the Remuneration Committee.

Q5 Do you agree with the changes to the Code relating to principal risks and monitoring the risk management system?

Overall we agree with the changes to the Code regarding principal risks and monitoring the risk management system.

However, we believe that section C.2 on 'Risk Management and Internal Controls' should come before C.1 'Financial and Business Reporting', as the former logically and chronologically precedes the latter in terms of assessment.

As we had previously set out in our response to the FRC consultation on Risk Management, Internal Controls and Going Concern (January 2014), there is too much focus on the traditional perception of risk being a 'threat', which is apparent in the wording of the Main Principle in Section C.2. We strongly believe that 'opportunity' risk should be identified and assessed, as it is one of the main areas that companies now need to consider. Such risks could be one of the highest risks in terms of companies not achieving strategic objectives. From a strategic point of view, risks that may be either a threat or an opportunity should be

considered. The overall responsibility of the board should also cover the whole risk profile and not just the 'principal' risks – this is more relevant to reporting (see our comments below on this).

Consequentially, we suggest that the wording of the Main Principle is changed as follows:

> *The board is responsible for determining the nature and extent of the risks,* ***both threats and opportunities****, it is willing to take in achieving its strategic objectives. The* ***company, under the direction of the board,*** *should maintain sound risk management and internal control systems.*

Regarding C.2.1, it should be made clear that the reference to the assessment of the overall 'risks facing the company' is carried out whilst describing 'the principal risks' and explaining how they are managed. For clarity, we suggest that the paragraph is split into two sentences, with the second making reference to what goes into the annual report.

Under C.2.3, we believe that the paragraph should mention that boards should regularly monitor the company's risk management and internal control systems, and that that monitoring should cover all material risks and controls. Our proposed changes to this paragraph would be the following:

> *The board should* ***regularly monitor*** *the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover* ***all material risks and controls****, including financial, operational and compliance controls.*

Q6 Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?

We welcome the retention of the positive accounting going concern statement as we believe the importance of assessing going concern should be emphasised; it allows companies to produce a sufficiently detailed going concern assessment and minimise lack of consistency while helping the work of the auditor. Also, it is considered by investors to be very useful. This is in line with our previous response to the FRC consultation on Risk Management, Internal Controls and Going Concern (January 2014), where we stated that there was an apparent change of emphasis by the FRC and that the importance of going concern should not be downgraded.

However, we believe there is a need to better link and cross-refer the going concern and viability statements. The draft Guidance notes indicate that "companies need to consider how best to link C1.3 and C2.2". We believe that the current wording is not entirely clear what the links and differentiation between the two statements should be; it would be useful if the FRC could provide more detail on the distinction of the two statements in the guidance and how they complement each other.

Q7 Do you agree with the way proposed Provision C.2.2 addresses the issues of the basis of the assessment, the time period it covers and the degree of certainty attached?

As mentioned in our response to Q6, it is not clear from the wording of C.2.2 and C.1.3 and the accompanying guidance should explain the difference between the two statements.

Q8 Do you have any comments on the draft guidance in Appendix B on the going concern basis of accounting and / or the viability statement?

We welcome that general guidance is provided. We believe that it would be useful to see how the Appendix B draft extracts will fit into the new draft Guidance document that supports the Code.

As previously noted in our response to the FRC Consultation on Risk Management, Internal Control and Going Concern (January 2014), in combining the going concern guidance and risk management documents a lot of the detail of the 2009 going concern guidance may have been lost. We noted our concern that this may be seen as a change of emphasis by the FRC, downgrading the importance of assessing going concern. Financial risks are often perceived to be well managed, with structured controls in place and attention paid to managing those risks. Hence, residual risk is often seen as low and companies may not accord going concern the amount of forward-looking attention that it requires under the new proposals. This may also make things more difficult for the auditor, as companies may not produce a sufficiently detailed going concern assessment and there may initially be a lack of consistency. We are concerned that, by combining the new guidance with the risk management and internal control systems there may be the risk of making it less clear whether companies that do not apply the Code will be able to continue to use it in the same way and also whether these smaller companies will be able to appropriately differentiate between guidance that is relevant to their size and that which is more relevant to Code companies.

The wording in the second paragraph should be consistent with C.2.1 if the change we propose is taken into consideration. In that case the words 'principal risks' should be removed.

As previously stated, we believe that identifying 'threats' as opportunities should be included in the 'Principal risks' section (p.28 of the consultation document). We strongly believe that 'opportunity' risk should be considered, as it is one of the main areas that companies now need to consider since this could be one of the highest risks in not achieving strategic objectives. Also, there are some potential changes in respect of the board's assessment of risks vs. reporting the 'principal risks'.

Since the report on the going concern would be based on that knowledge acquired through the analysis of the principal risks, we suggest changing the order of the paragraphs to reflect that, ie (i) Principal risks; (ii) Statement on risk management and internal control; (iii) Reasonable expectation that the company can continue in operation; and (iv) Going concern basis of accounting.

Q9 Should the FRC provide further guidance on the location of the viability statement?

We believe that the location of the viability statement is appropriate. No further guidance is necessary.

Q10 Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?

Yes, we believe that the recommendation that companies report on actions being taken to address significant failings or weaknesses should be retained.

As previously supported in our response to FRC Consultation on Risk Management, Internal Control and Going Concern (January 2014), we agree that this is an area that needs greater transparency, as companies tend to be reluctant to disclose information that they consider may put them at some competitive disadvantage. However, they need to balance this with the need for the annual report and accounts to give sufficient information to reassure shareholders that their risk management and internal control framework is effective, with appropriate measures in place to identify and address failings.

We believe that the guidance should be more explicit in this area in order to try to counter companies reverting to boilerplate responses. However, we also believe that there also needs to be some form of review and feedback mechanism on what is being presented, which should be actively monitored by the FRC.

Q11 Should the option of giving companies the possibility of putting the full corporate governance statement on their website be considered further? If so, are there any elements of the corporate governance statement that should always be included in the annual report?

Yes, we believe that the option of giving companies the possibility of putting the full corporate governance statement on their website should be considered further. The information included in the corporate governance statement is generally the same from year to year; putting this information on companies' websites may allow companies to provide richer, more detailed information about their corporate governance practices.

Q12 Are there any disclosure requirements in the Code that could be dropped entirely?

No, we do not believe there are any disclosure requirements in the Code that could be dropped entirely.

If you would like to discuss any of our responses in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Corporate Governance Expert Group

Edward Craft (Chairman)	Wedlake Bell LLP
Colin Jones (Deputy Chairman)	UHY Hacker Young
Victoria Barron	Hermes Equity Ownership Services
Edward Beale	Western Selection Plc
Rob Burdett	FIT Remuneration Consultants
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Richie Clark	Fox Williams LLP
Louis Cooper	Crowe Clark Whitehill LLP
Madeleine Cordes	TMF Corporate Secretarial Services Ltd
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Peter Fitzwilliam	The Mission Marketing Group PLC
David Fuller	CLS Holdings PLC
Nick Gibbon	DAC Beachcroft LLP
Nick Graves	Burges Salmon
Andrew Hobbs	EY
Alexandra Hockenhull	Xchanging plc
David Isherwood	BDO LLP
Nick Janmohamed	Speechly Bircham LLP
Dalia Joseph	Oriel Securities Limited
Claire Noyce	Hybridan LLP
Anita Skipper	Aviva Investors
Julie Stanbrook	Hogan Lovells International LLP
Nicholas Stretch	CMS Cameron McKenna LLP
Peter Swabey	ICSA
Eugenia Unanyants-Jackson	F&C Investments
Melanie Wadsworth	Faegre Baker Daniels LLP
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Edward Beale	Western Selection Plc
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Ian Davies	Vislink PLC
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Jack Easton	UHY Hacker Young
Bill Farren / Ian Smith	Deloitte LLP
David Gray	DHG Management
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Barbara Allen/ Anika Chandra	Stephenson Harwood
Emma Bailey	Fox Williams LLP
Martin Benson	Baker Tilly
Danny Blum	Eversheds LLP
Stephen Chater / Robert Postlethwaite	Postlethwaite & Co
Sara Cohen	Lewis Silkin
Karen Cooper	Osborne Clarke
Rory Cray	FIT Remuneration Consultants
David Firth	Penna Consulting PLC
Philip Fisher/ Andy Goodman	BDO LLP
Amanda Flint / Richard Sharman/ Amanda Stapleton	Grant Thornton UK LLP
David Fuller	CLS Holdings PLC
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