Corporate governance – what you need to know

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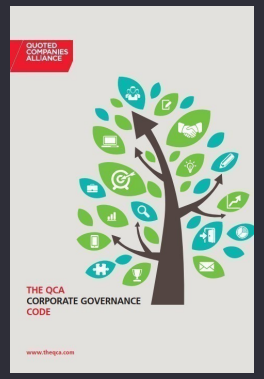
Building a better working world

Agenda

- Why the changes for large private companies?
- Statement of Corporate Governance
- Wates Principles
- Section 172(1) and stakeholder reporting
- Reporting on changes relating to Corporate governance

Overview of changes



STATUTORY INSTRUMENTS

2018 No. 860

COMPANIES

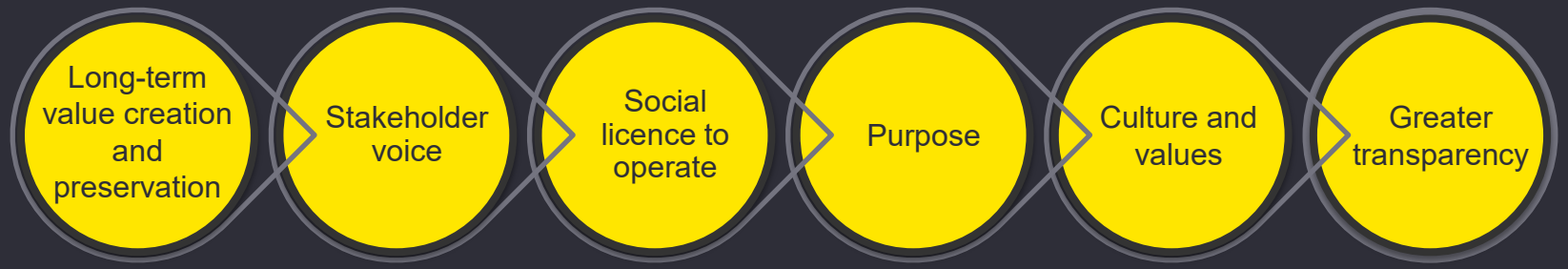
The Companies (Miscellaneous Reporting) Regulations 2018

Made - - - - 17th July 2018

Coming into force in accordance with regulation 1

The Secretary of State makes the following Regulations in exercise of the powers conferred by sections 396(3), 404(3), 416(4), 421(1) to (2A), 468 and 1292(1)(a) and (c) of the Companies Act 2006(**a**), and sections 34(3)(a) and 62(2) of the Companies (Audit, Investigations and Community Enterprise) Act 2004(**b**).

In accordance with sections 473, 1290 and 1292(4) of the Companies Act 2006, and section 62(4) and (5) of the Companies (Audit, Investigations and Community Enterprise) Act 2004, a draft of this instrument was laid before Parliament and approved by a resolution of each House of Parliament.



> (…) the conduct and governance of large companies, whatever their legal status, has a sizeable impact on the interests of employees, suppliers, customers and others.

Governance for private companies … why?

“

20,000 current and former BHS employees face reductions to their pensions of up to 77%.

“

The jobs of the 11,000 employees of BHS, … are now at risk.

“

That private companies are not subject to the same transparency requirements and codes of conduct as their public counterparts in no way absolves them of their wider responsibilities. Parliament is rightly cautious about imposing onerous new duties on our companies; but if large public or private companies do not behave in accordance with the ethical standards that society expects, further regulation may need to be considered. Ultimately business has a moral responsibility to operate within a framework which enjoys the confidence of the nation

“

(…) the conduct and governance of large companies, whatever their legal status, has a sizeable impact on the interests of employees, suppliers, customers and others.

Companies (Miscellaneous Reporting) Regulations 2018 (MRR)

Statement of corporate governance arrangements

Section 172(1) statement

Stakeholder interests

Employee engagement

CEO pay ratio ***(public quoted companies only)***

At an **individual company level**

- >2,000 global employees (on average) and/or
- Turnover>£200mn & Total Assets>£2bn

Any company (or Group) that meets two of the three size criteria

- Turnover: £36mn or more
- Balance sheet £18mn or more
- 250 employees or more

- 250 **UK** employees or more

Scope includes UK subsidiaries of groups (listed or unlisted), that meet the size criteria

Statement of corporate governance arrangements

Corporate governance statement: the requirements

At an individual company level:

>2,000 global employees

&/or

Turnover>£200m & Total Assets>£2bn

Recognised code NOT applied

- Reason for not applying a code
- Explanation of the alternative CG arrangements

Recognised code applied

- Which corporate governance code
- How the code was applied
- Any departures from the code
- Reasons for departure

Scope includes UK subsidiaries of groups (listed or unlisted), that meet the size criteria

Corporate governance statement: what you need to consider

Recognised codes

- Wates Principles (written primarily for large private companies)
- UK Corporate Governance Code (mandatory for Premium listed companies on the Official List)
- Quoted Companies Alliance Code (popular with AIM listed companies)
- AIC Code (aimed at investment trust companies)
- Foreign codes

Wates Principles overview

Wates Principles – applicable to large, private companies

1
Principle One
Purpose and Leadership

2
Principle Two
Board Composition

3
Principle Three
Director Responsibilities

Principle Four
Opportunity and Risk
4

Principle Five
Remuneration
5

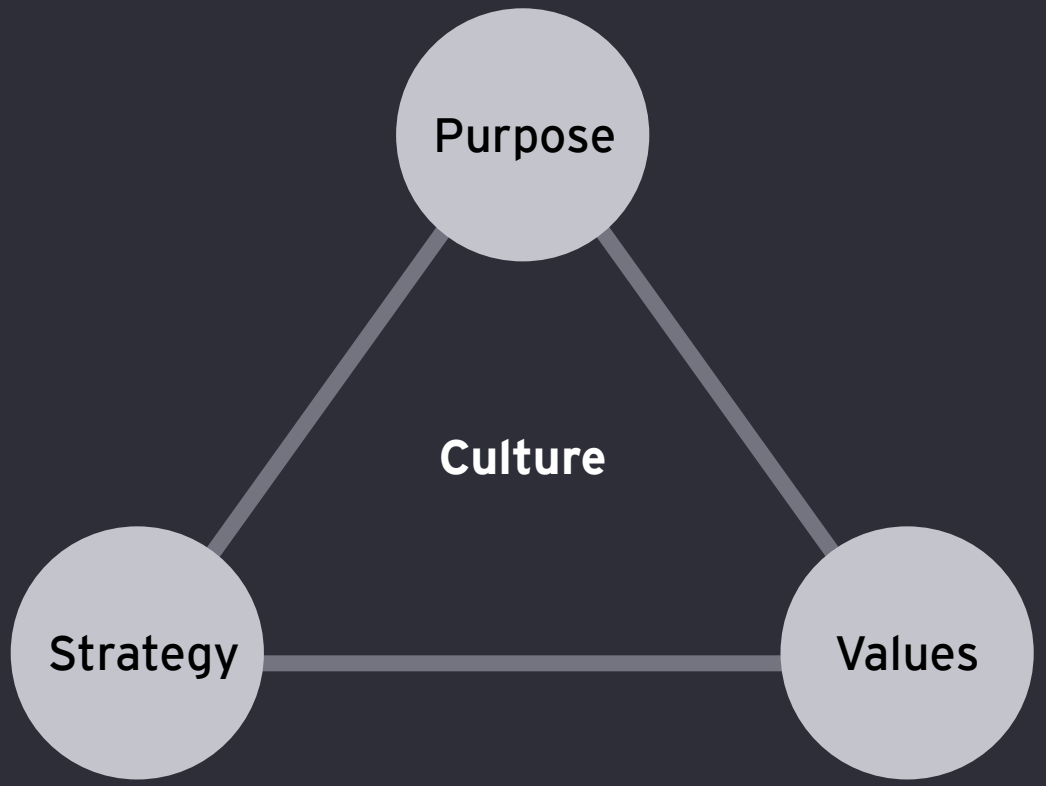
Principle Six
Stakeholder Relationships and Engagement
6

- Set of governance principles that are high level, proportionate and flexible
- Apply and explain principles
- Associated guidance for each principle

Purpose and Leadership

1

An effective board develops and promotes the **purpose** of a company, and ensures that its **values**, **strategy and culture** align with that purpose.



Board composition

2

Effective board composition requires an **effective chair and a balance of skills, backgrounds, experience and knowledge**, with individual directors having **sufficient capacity** to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

- The Chair and overall effectiveness
- The balance of directors

Director responsibilities

3

The board and individual directors should have a clear understanding of their **accountability and responsibilities**. The board's **policies and procedures** should support effective decision-making and independent challenge.

- Accountability
- Other considerations

Opportunity and risk

4

A board should promote the **long-term sustainable success** of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

- Opportunity
- Risk and internal control framework

Remuneration

5

A board should promote executive **remuneration structures aligned** to the long- term sustainable success of a company, taking into account pay and conditions elsewhere in the company.

Stakeholder relationships & engagement

6

Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for **overseeing meaningful engagement** with stakeholders, including the workforce, and having regard to their views when taking decisions.

- Workforce engagement
- Stakeholder engagement

Explanations in support of applying this principle will be closely aligned to section 172 reporting and reporting on workforce engagement as required under MRR.

Section 172(1) and stakeholder reporting

Section 172(1)

Requirement	Scope
Section 172(1) statement: A statement in the Strategic Report to set out how directors have had regard to the matters set out in Section 172 (1) (a)-(f).	UK incorporated companies that prepare a Strategic Report (unless they qualify as medium-sized[1])

[1] Except if in an ineligible group

- s172(1): A director of a company must act in the way he considers, in good faith, would promote the success of the company for the benefit of its members as a whole and in doing so have regard (among other matters) to the following factors:
  a. The likely consequences of any decision in the long-term;
  b. The interests of the company's employees
  c. The need to foster the company's business relationships with suppliers, customers and others;
  d. The impact of the company's operations on the community and the environment;
  e. The desirability of the company maintaining a reputation for high standards of business conduct; and
  f. The need to act fairly as between members of the company.

Section 172(1) – the details

Requires active involvement – demonstrate that matters were considered, not rubber-stamped.

Success is not defined – but generally accepted to mean long-term, sustainable profitability.

General duty on every company director owed to the company itself.

The list of factors that directors need to consider in exercising their role is non-exhaustive.
The factors are designed to ensure that broader implications of decisions are thought through.

A director of a company must act in the way he

- considers, in good faith,
- would promote the success of the company
- for the benefit of its members as a whole
- and in doing so have regard (among other matters) to the following factors:

Section 172(1) – the details (continued)

DECISIONS

ENGAGEMENT

a) the likely consequences of any decision in the long-term;

b) the interests of the company's employees;

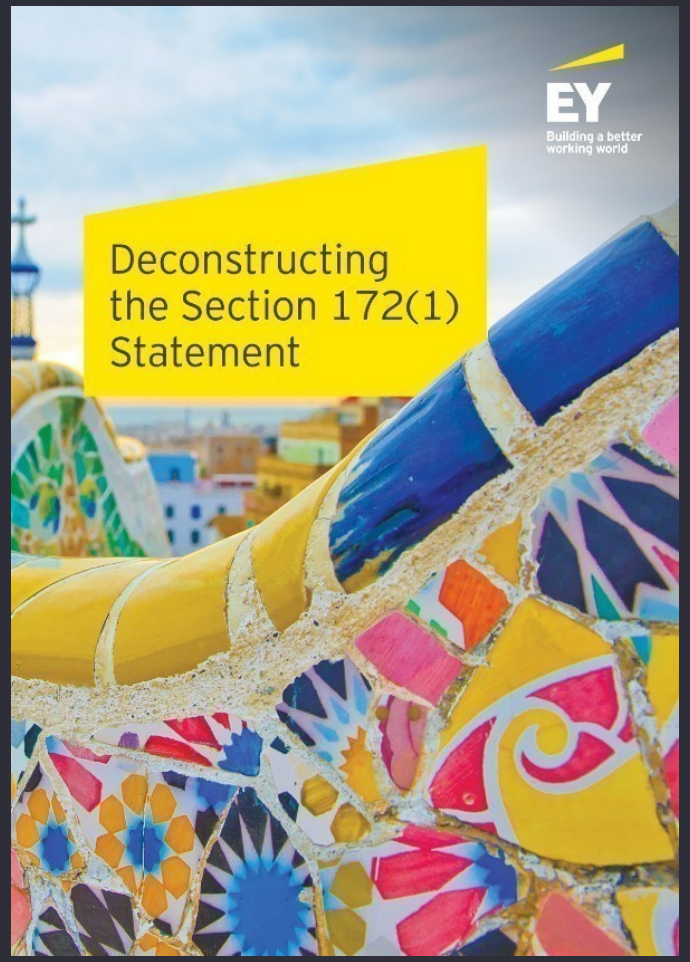
c) the need to foster the company's business relationships with suppliers, customers and others;

d) the impact of the company's operations on the community and the environment;

e) the desirability of the company maintaining a reputation for high standards of business conduct; and

f) the need to act fairly as between members of the company.

EY's Deconstructing the s172 (1) statement



Download at: **ey.com/corporategovernance**

EY's s172 practical guidance

- Two step framework:
  - Step 1: Stakeholder engagement
  - Step 2: Principal decisions
- Assists in meeting the requirements of MRR
- Consolidates requirements
- Illustrative examples to help with drafting
- Road-tested
- Practical considerations for underlying processes

Employee and stakeholder engagement

Requirement	Scope
Employee engagement Directors' Report: Detail how directors have engaged with employees, and the effect of their regard for employee interests on principal decisions taken by the company.	All companies with 250 UK employees or more
Stakeholder Engagement The Directors' Report: summarise how directors have had regard for suppliers, customers and others, and the effect of that regard on principal decisions taken by the company.	Any two of the below: ▶ Turnover £36m or more ▶ Balance sheet £18m or more ▶ 250 employees or more

Employee and stakeholder engagement (continued)

	Employees	Suppliers, customers and other stakeholders
How directors have engaged with the stakeholders	Yes[1]	No
How directors have had regard to these stakeholders	Yes	Yes
The effect of their engagement and regard on principal (Board) decisions	Yes	Yes
Actions taken during the year to keep stakeholders informed, regularly consulted, involved in performance and aware of financial and economic factors affecting the company	Yes	No

[1] Companies will need to consider whether their engagement processes provide directors with the necessary exposure to employees.

Stakeholder engagement – National Grid plc example

Stakeholder group	Form of engagement	How this stakeholder group influenced the Committee/Board agenda and decision-making
Our customers The users of our products and services. In the UK, our key customers are electricity and gas distributors and generators. In the US, we have more than seven million retail bill payers. By delivering the energy they need and dealing with them in a transparent and responsive manner, our customers trust us to deliver services of value to them.	**UK customer programme** – the UK Customer Experience Board is chaired by the Executive Director, UK, and attended by the entity and functional directors. Each member attends regular customer meetings to listen to what matters most to our customers and build strategic relationships. Customers are invited to attend the Customer Experience Board and group immersion events are held where Executive Directors hear from customers about their concerns in the industry. An annual survey to senior customer contacts provides useful feedback on the level of satisfaction and customer advocacy. Proxy co-creation stakeholder user group – created to represent a wide range of stakeholders including large and small customers and consumers. The group has challenged the Company's approach to engagement and are currently analysing the Company's Business Plan. **US customer team** – collects and communicates 'voice of customer' throughout the business. Each jurisdiction facilitates a range of listening surveys for brand perception and customer satisfaction during transactions. A new online panel has been created of over 6,000 residential customers to contribute ideas and feedback continuously.	In the year, the Executive Committee and Board received updates on both the UK and US customer strategies. Biannual reports are also submitted to the Board from UK, US and NGV. **UK** – feedback received influences decision-making at customer and entity team level. It was used to help shape the Company's five customer principles (care, agility, trust, transparency and value), and the UK customer ambition. **US** – the Executive Committee and Board received updates on, and approved the recent US rate case filings.

National Grid plc, 2018 ARA (page 54)

Principal decisions – Derwent London plc example

1. Summary of the decision

2. Impact

3. Stakeholder considerations

THE FEATHERSTONE BUILDING EC1

In June 2018, the Board approved the redevelopment of Monmouth House 58-64 City Road and 19-23 Featherstone Street into a new development – The Featherstone Building – which will see the existing buildings demolished and the new development constructed on the existing site. The Featherstone Building will provide 110,000 sq ft of commercial office space, 2,000 sq ft of retail space on the ground floor and 13,000 sq ft of small/micro workspace on the ground and lower floors.

In addition to making a satisfactory return to our shareholders, our stakeholder impact analysis identified the following additional key benefits to our stakeholders:

- The Featherstone Building will assist with the regeneration of the Old Street Yard area through its design, additional retail and office space and employment opportunities.
- To assist small local businesses and start-ups, the small/micro workspace will be let at 75% of market rent and will be fully fitted out for immediate occupancy.
- Construction trainees will be employed through Skanska (the project's principal contractor) to provide employment and development opportunities.
- Where possible, we will use local procurement opportunities.
- As part of our planning obligations, we are required to provide funding (s106 contributions and Community Infrastructure Levy) for local infrastructure, including affordable housing, carbon offsetting, employment, Crossrail and TfL cycle hire.

Our stakeholder impact analysis identified the following key concerns:

- increased traffic in the area during development;
- increased noise during the project; and
- general disruption to the surrounding area including local businesses.

To mitigate the impact on the local neighbourhood, we have produced neighbourhood liaison plans which set out the project phases, timetable and details of site representatives to contact if any issues arise during the project. In addition, monthly newsletters will be sent throughout the project to local residents. Although cycles routes and pedestrian routes will be redirected during construction, we will ensure they are safely maintained for the duration of the works. Extensive consultation has been undertaken with Islington Council to develop our construction management and logistic plans.

Derwent London plc,
2018 ARA (page 94)

Reporting on changes relating to Corporate governance

Reporting on changes relating to Corporate governance

- Establish a company's purpose
- Assess and monitor culture
- Stakeholder and workforce engagement (+MRR - s172 overlap)
- Robust assessment of emerging risks
- Wider remit of remuneration committee (+MRR CEO pay ratio requirement)
- Length of service, including 9 year chair tenure limit
- Wider remit of the nomination committee

Overview: EY's analysis of reporting trends

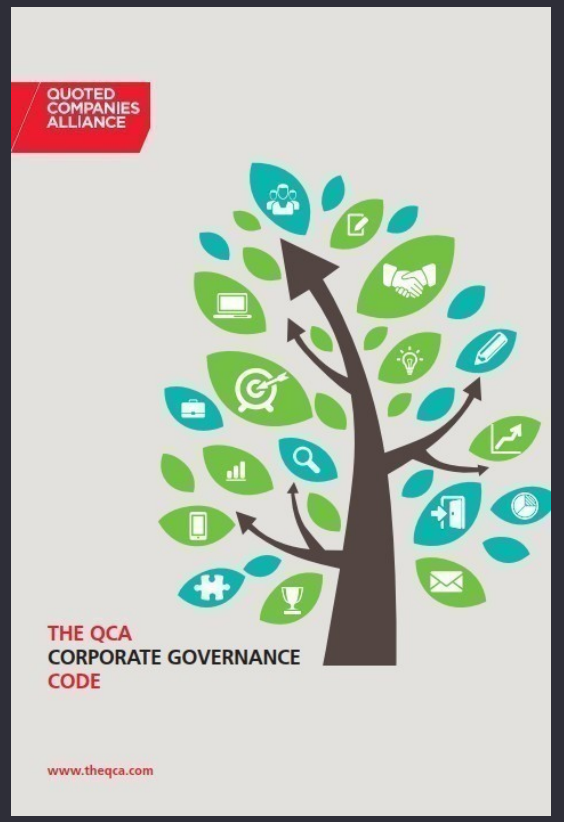
- Insight on early reporting practices observed relating to new governance requirements:
  - Articulating purpose and culture
  - Stakeholder engagement and s172
  - Board evaluations and talent planning
  - Emerging risks
  - Board evaluations and talent planning
  - Broadened responsibilities of the remuneration committee
- Practical ideas on how companies can further develop and refine this reporting
- A look ahead

Quoted Companies Alliance (QCA) Code

The QCA Code provides AIM companies and other small listed companies (non-premium listed) with a corporate governance framework that may be more appropriate than the UK Corporate Governance Code.

The QCA code:

- Contains ten corporate governance principles
- Provides an explanation of what each of these principles entails
- Requires the chair to provide a corporate governance statement
- Provides a set of corporate governance disclosure requirements



Key takeaways

- Increased scrutiny of narrative disclosures – regulators and other interested stakeholders.
- Reporting is an outcome — focus on robustness of underlying governance processes.
- Grasp the spirit – or face the risk of more invasive regulation in the future.
- Be balanced and open — report progress to date vs. what is still WIP/needs to be addressed.
- Be prepared to review and evolve in future years.

Thank you