Unlocking the code

Deborah Ritchie speaks to Mark Butterworth about the proposed revisions to the UK Corporate Governance Code

Mark Butterworth is managing director at Condie Risk Consultancy. The former chairman of Airmic, Butterworth has enjoyed a long career in the financial services industry, specialising in risk management and corporate governance for the last 25 years. At Condie Risk, Mark provides risk consulting, interim senior level risk management services and risk and insurance training programmes for all sectors of business and industry. He also leads on the Condie Independent Board Effectiveness Reviews.

CIR spoke to Mark about the Financial Reporting Council's recent consultation on the new UK Corporate Governance Code. The council has made numerous changes to the code since the original version was published in 1992, but this year has taken a root and branch approach to its revision.

What is background to this overhaul of the UK Corporate Governance Code?

It has been 25 years since the first Corporate Governance Code was published in the UK. The Cadbury Code and Report established the concept of a benchmark for good governance in companies listed on the London Stock Exchange. The code was also widely adopted as the standard for all other types of organisations.

The code has had numerous adjustments in recent years. But governance best practice moves on and this time the FRC is undertaking "a comprehensive review to ensure that the code remains fit for purpose".

Proposals include a significant restructuring of the Code, with an enhanced role for board effectiveness requirements, and elevated importance of culture management in firms.

What direction does the new approach take?

The new approach essentially recognises that good governance and risk management can only be achieved through an effective board of directors. The council's proposals note that a well-managed culture brings integrity, confidence, long-term success and trust; and that, conversely, a poor culture is a significant risk. Boards and risk managers are expected to be able to measure and quantify the status of culture in the organisation.

What are the key themes of the proposals?

It is expected that the new code will be shorter and sharper, with certain sections removed and others transferred to the Guidance on Board Effectiveness – which in practice means that users will have to take account of both publications. It is worth noting that the latter was published in 2011 and that the expectations of boards has moved on materially since then, particularly in regard to what constitutes effectiveness – so the revision of that particular document is extensive!

As you know, the role of the chair remains a key feature within board effectiveness, with a heightened requirement to lead the annual board evaluation, rather than just take responsibility for acting on results. Culture is a very topical issue and one that directors may expect to be challenged on. A helpful move by the FRC has been the inclusion of sets of questions that boards can use to check their compliance.

The new code places greater responsibility and an expanded remit for the RemCo, building on culture and workforce engagement. Among the implications for firms is the question of the frequency of meetings of the RemCo, where the tendency to have two or three meetings a year is unlikely to be sufficient, given the expanded brief of the committee.

Conversely, there are relatively few proposed changes under the audit and risk heading. Nevertheless, the broader code review clearly ramps up the expectation that boards should proactively set the risk culture and appetite in the organisation. The FRC places some importance on the approach firms take to compiling the

"Proposals include a significant restructuring of the Code, with an enhanced role for board effectiveness requirements and culture management"

"It is expected that the new code will be shorter and sharper, with certain sections removed and others transferred to the Guidance on Board Effectiveness"

Mark Butterworth, managing director, Condie Risk Consultancy

Viability Statement.

A material change to the proposed code is the addition of a provision requiring the adoption (on a comply or explain basis) of one (or more) of three employee engagement mechanisms, as part of the wider concept of understanding stakeholder views. The draft code goes on to define a modern view of "workforce" to include all those engaged by the firm, including agency workers and contractors. Those firms with smaller workforces may feel the proposed requirement to be too prescriptive and unmanageable and are more likely to explain why they have not adopted this provision in future annual reports.

What do the proposals suggest as regards board composition, independence and tenure?

The proposed new code states that the chair should be able to demonstrate independence at all times. This leads on to the provision that the majority of members of the board – now including the chair – should be regarded as independent, rather than the majority excluding the chair as at present. In regard to the chair and all other NEDs, emphasis is placed on only being considered independent if they do not have any current or previous relationships with the company or a significant shareholder.

The consultation paper goes on to say that where an NED serves for more than nine years on the board they can no longer be seen as independent. The FRC reminds us that this is consistent with the Code's approach to succession planning and the importance of board refreshment.

"Whilst acknowledging progress in this area, the proposals seek a greater effort and broader public reporting of gender, social and ethnic backgrounds"

Do the new proposals acknowledge the theme of diversity?

There is broad agreement that diversity in the workplace brings better financial performance. Whilst acknowledging there has been notable progress in this area, the proposed revisions to the code seek greater effort and broader public reporting of gender, social and ethnic backgrounds. The responses to the consultation proposals may well be cautious here, as data on these matters may not currently be available and only developed over time.

Finally, what is the timetable for the revised Code?

A thorough analysis of current practices as against the new Code expectations is recommended to ensure systems are in place prior to the effective start of the new approach in January 2019.

Interview by Deborah Ritchie